Supreme Court, U.S.
FILED

(1) 03 932 DEC 24 2003

No. 03-

IN THE

Supreme Court of the United States

DURA PHARMACEUTICALS, INC.; CAM L. GARNER; JAMES W. NEWMAN; CHARLES W. PRETTYMAN; WALTER F. SPATH; JAMES C. BLAIR; JULIA R. BROWN; JOSEPH C. COOK, JR.; and MITCHELL R. WOODBURY,

Petitioners,

v.

MICHAEL BROUDO; BALDEV S. GILL; LARRY MORGAN IRA; LEONID SHVARTSMAN, (for G&S partnership); NEIL SISKIND; ROBERTA SPECK; BRENT VOGT, on behalf of themselves and all others similarly situated,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

WILLIAM F. SULLIVAN
Counsel of Record
CHRISTOPHER H. MCGRATH
TRACEY L. DELANGE
PAUL, HASTINGS, JANOFSKY & WALKER LLP
3579 Valley Centre Drive
San Diego, CA 92130
(858) 720-2500

Attorneys for Petitioners

184705

COUNSEL PRESS
(800) 274-3321 • (800) 359-6859

QUESTION PRESENTED

Whether a securities fraud plaintiff invoking the fraud-on-the-market theory must demonstrate loss causation by pleading and proving a causal connection between the alleged fraud and the investment's subsequent decline in price.

STATEMENT PURSUANT TO RULE 29.6

Pursuant to Supreme Court Rule 29.6, petitioner Dura Pharmaceuticals, Inc. states that on December 31, 2001 Dura Pharmaceuticals, Inc. merged with and into Elan Pharmaceuticals, Inc., a privately held Delaware corporation, which is a wholly-owned subsidiary of Elan Corporation, plc. a publicly-traded entity.[1]

1. In the caption page to its opinion, 339 F.3d 933 (9th Cir. 2003), the Ninth Circuit inadvertently listed certain non-parties as defendants/appellees. Merrill Lynch and Co./Merrill Lynch, Pierce, Fenner and Smith, Inc. were omitted by the plaintiffs/respondents from the Consolidated Amended Complaint and did not appear before the court of appeals. Nissan Motor Co., a Japanese corporation, was never a party in this case.

TABLE OF CONTENTS

	Page
Question Presented	i
Statement Pursuant to Rule 29.6	ii
Table of Contents	iii
Table of Cited Authorities	v
Table of Appendices	viii
Opinions Below	1
Statement of Jurisdiction	1
Statutory Provisions Involved	1
Statement of the Case	2
Reasons for Granting the Petition	6
I. The Ninth Circuit Has Decided An Important And Recurring Issue Of Federal Securities Law – Loss Causation – In A Manner That Creates A Real And Intolerable Conflict Among The Circuits	7
A. Most Circuits Apply A Loss Causation Rule Different From That Applied By The Ninth Circuit Here	8

Contents

	Page
1. The Eleventh Circuit	8
2. The Third Circuit	10
3. The Second Circuit	11
4. The Seventh Circuit	12
B. Only The Eighth Circuit Agrees With The Ninth Circuit	13
C. This Court Should Resolve The Conflict	14
II. The Ninth Circuit's Interpretation Of Loss Causation Cannot Be Squared With The Text Of The Reform Act	15
Conclusion	19

TABLE OF CITED AUTHORITIES

	Page
Cases:	
Bastian v. Petron Resources Corp., 892 F.2d 680 (7th Cir. 1990)	12, 13
Emergent Capital Investment Mgt., LLC v. Stonepath Group, Inc., 343 F.3d 189 (2d Cir. 2003)	11, 12
Gebhardt v. Conagra Foods, Inc., 335 F.3d 824 (8th Cir. 2003)	13
Gillespie v. United States Steel Corp., 379 U.S. 148 (1964)	6
Huddleston v. Herman & MacLean 640 F.2d 534 (5th Cir. 1981)	7, 9
In Re Control Data Corp. Securities Litigation, 933 F.2d 616 (8th Cir. 1991)	8-9, 13
Knapp v. Ernst & Whitney, 90 F.3d 1431 (9th Cir. 1996)	8
Robbins v. Kroger Properties, Inc., 116 F.3d 1441 (11th Cir. 1997)	6, 8, 9
Semerenko v. Cendant Corp., 223 F.3d 165 (3d Cir. 2000)	6, 10

Cited Authorities

Page

Suez Equity Investors, L.P. v. Tornoto-Dominion Bank, 250 F.3d 87 (2d Cir. 2001) 11, 12

United States v. General Motors Corp., 323 U.S. 373 (1945) 6

Statutes & Rules:

15 U.S.C. § 78a, *et seq.* 1

15 U.S.C. § 78u-4(b)(4) 15

15 U.S.C. § 78u-4(e)(1) 17

Securities Exchange Act of 1934 Section 10(b) 9, 15, 17

Private Securities Litigation Reform Act of 1995, P.L. 104-67, 1995 HR 1058 1

S. Rep. No. 104-98 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679 18

Fed. R. Civ. P. 12(b)(6) 12

Cited Authorities

Page

Articles:

Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 Stan. L. Rev. 487, February 1991 6

David Brodskey & Jeff Hammel, *The Fraud on the Market Theory and Securities Fraud Claims*, 230 N.Y.L.J. 4 @ Col. 4, October 24, 2003 15

David S. Escoffery, *A Winning Approach to Loss Causation Under Rule 10b-5 in Light of the Priviate Securities Litigatio Reform Act of 1995*, 68 Fordham L. Rev. 1781, April 2000 15

Sarah Gold & Leon Gold, *Clarifying the Pleading of Loss Causation: A direct causal link between the alleged misrepresentation or omission and the economic loss suffered must be demostrated*, 230 N.Y.L.J. 3 @ Col. 1, October 8, 2002 14

TABLE OF APPENDICES

	Page
Appendix A — Opinion Of The United States Court Of Appeals For The Ninth Circuit Dated And Filed August 5, 2003	1a
Appendix B — Order Of The United States District Court For The Southern District Of California Dated November 2, 2001	18a
Appendix C — Order Of The United States Court Of Appeals For The Ninth Circuit Denying Petition For Rehearing And Rehearing En Banc Dated September 25, 2003 And Filed September 29, 2003	52a
Appendix D — Statute Involved	54a

Petitioners respectfully pray that a writ of *certiorari* issue to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The order of the district court granting petitioners' motion to dismiss the second amended complaint with prejudice is not reported, but is reprinted in the Appendix ("Pet. App.") at 18a-51a. The Ninth Circuit opinion (Archer, J., joined by Reinhardt and Pregerson, JJ.)[2] reversing the district court is published at 339 F.3d 933 (9th Cir. 2003) and reprinted at Pet. App. 1a-17a.

STATEMENT OF JURISDICTION

The court of appeals entered its opinion and order on August 5, 2003. A timely petition for rehearing and rehearing *en banc* was filed. On September 29, 2003, the panel, before Pregerson, Reinhardt, and Archer, JJ., denied the petition for rehearing and the suggestion for rehearing *en banc* was rejected. (Pet. App. at 52a-53a). This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The provisions of the Securities Exchange Act of 1934, 15 U.S.C. § 78a, *et seq.*, relevant to this petition, including the Private Securities Litigation Reform Act of 1995 (the "Reform Act"), P.L. 104-67, 1995 HR 1058, are reproduced at Pet. App. 54a-55a.

---

2. The Honorable Glenn L. Archer, Jr., Senior Circuit Judge, United States Court of Appeals for the Federal Circuit, sitting by designation.

STATEMENT OF THE CASE

The Ninth Circuit's decision acknowledges that it conflicts with those from other Circuits. The Ninth Circuit allowed this case to proceed on a bare allegation that a security's price was "inflated," without showing proof of a subsequent decline in price that related to the alleged "inflation." Other Circuits, the Ninth Circuit acknowledged, require proof of loss causation: "a corrective disclosure followed by a stock price drop." (Pet. App. 9a n.4.) This Court should grant review to resolve that acknowledged conflict.

1. Petitioner Dura Pharmaceuticals, Inc. ("Dura") was a San Diego-based developer and marketer of prescription pharmaceutical products for the treatment of allergies, asthma, and related respiratory conditions. The individual petitioners herein held various management and/or director positions with Dura. Respondents are investors who purchased shares of Dura between April 15, 1997 and February 24, 1998 (the "Class Period").

2. On February 24, 1998 Dura announced that it expected a revenue shortfall for the upcoming full year due to anticipated slow pharmaceutical sales, increased competition and a need to increase Dura's sales force. The announcement said nothing about Albuterol Spiros, Dura's delivery device for asthma medication, which was in development in coordination with the United States Food and Drug Administration ("FDA"), and not yet FDA-approved. Following this announcement, Dura's stock dropped from $39.125 on February 24, 1998 to $20.75 on February 25, 1998, a 47% one-day loss.[3]

3. Plaintiffs rely upon intra-day trading highs and lows in Dura common stock to enhance their allegations. On February 24, 1998 Dura's shares closed at $38.125. Supplemental Excerpts of Record (Vol. 2) ("SER"), 79, Exh. L (Dura common stock price history). On February 25, 1998 Dura's shares closed at $23.938. *Id.*

3. On November 3, 1998, nearly nine months after Dura's February 24, 1998 announcement and the concurrent loss in stock price, Dura announced that the FDA did not approve Albuterol Spiros due to issues of electro-mechanical reliability and the need for additional clinical trials.[4]

4. Respondents filed a Consolidated Amended Complaint ("CAC") on October 7, 1999. Respondents allege that petitioners made materially false statements during the Class Period regarding, inter alia, the prospects of Albuterol Spiros. Respondents did not seek to recover losses associated with the November 3 announcement concerning Albuterol Spiros. Rather, respondents sought to recover for the 47% decline in price that followed the February 24 announcement of an anticipated prospective revenue shortfall. On July 12, 2000, the district court granted petitioners' motion to dismiss the CAC without prejudice. At such time, the district court admonished respondents that failure to comply with the requisite pleading standards may subject their complaint to dismissal with prejudice.

5. On November 2, 2001, the district court granted petitioners' motion to dismiss the Second Amended Complaint ("SAC") with prejudice and entered judgment in petitioners' favor. (Pet. App. 51a) The district court found, in relevant part, that respondents' allegations concerning Albuterol Spiros were insufficient to state a claim because

4. Dura's share price declined somewhat following the November 3 announcement, from $12.375 to $9.75. SER, 79, Exh. L. Within twelve trading days, however, the stock price recovered to $12.438, and within ninety days it closed at $14.00 per share. *Id.*

plaintiffs failed to plead the requisite "loss causation."[5] Specifically, the district court focused on the end of the Class Period and Dura's announcement on February 24, 1998 which was followed by a stock price decline:

> The SAC does not allege that the February 24, 1998, announcement contained any negative information about Albuterol Spiros. Rather, Dura did not announce that the FDA would not approve Albuterol Spiros until nine months later, in November 1998. (SAC ¶ 136.) The SAC does not contain any allegations that the FDA's non-approval had any relationship to the February price drop. Accordingly, the SAC does not explain how the alleged misrepresentations and omissions regarding Albuterol Spiros "touched" upon the reasons for the decline in Dura's stock price. Rather, the decline in Dura's stock price was the result of an expected revenue shortfall.

(Pet. App. 40a). The district court noted that because the February 24 announcement did not mention the Albuterol Spiros device, no omissions or misrepresentations about the device could be said to have caused the decline in price. The district court expressly rejected respondents' contention that they had properly pleaded loss causation because they alleged that the stock price on the date of purchase was inflated because of the misrepresentations or omissions and

5. In granting petitioners' motion to dismiss with prejudice, the district court also found that respondents failed to allege particularized facts establishing that any material statements were false or misleading when made, and failed to allege particularized facts establishing a strong inference of scienter.

they would not have purchased the stock had they known about the petitioners' wrongdoing. (Pet. App. 40a).

6. On respondents' appeal, the Ninth Circuit reversed in an opinion remarkable for its admitted conflict with well-established and authoritative decisions of other federal Circuits that have addressed the identical issue. The court of appeals acknowledged, consistent with the district court's reasoning, that the loss causation element is satisfied in the Ninth Circuit if "the plaintiff shows that 'the misrepresentation touches upon the reasons for the investment's decline.'" (Pet. App. 8a). But the Ninth Circuit found the "touches upon" language ambiguous enough to ignore the absence of any causal link between the Albuterol Spiros allegations and the Dura stock price decline following the February 24 announcement. The court of appeals allowed respondents to proceed on a price inflation theory unrelated to the actual February 24 revenue announcement and price decline.

According to the Ninth Circuit, in a fraud-on-the-market case, plaintiffs establish loss causation if they plead that the stock price on the date of purchase was inflated because of the misrepresentation. The court of appeals concluded that it is not necessary that a market price drop actually occur in order to establish loss causation. According to the court of appeals, to withstand a motion to dismiss, a plaintiff need only allege: (1) that the price at the time of purchase was overvalued; and (2) sufficient identification of the cause for the overvaluation. (Pet. App. 10a).[6]

6. In addition to its holding regarding loss causation, the court of appeals also vacated and remanded the district court's finding of no scienter, instructing the district court to consider the plaintiffs' allegations of scienter collectively, rather than separately. The court of appeals further found that the district court abused its discretion

(Cont'd)

REASONS FOR GRANTING THE PETITION

Two sound reasons for review exist. First, the Ninth Circuit's holding on loss causation contradicts (as the Ninth Circuit itself recognized, Pet. App. 9a n.4) decisions in the Eleventh, and Third Circuits,[7] in that it substitutes price inflation for the Congressionally mandated proof of loss. And, as will be detailed herein, the Ninth Circuit's interpretation (also recently supported by the Eighth Circuit) is also in conflict with decisions in the Second, Fifth and Seventh Circuits. Each of these other Circuits requires a plaintiff to plead and prove a causal connection between the alleged fraud and actual loss in stock price. Second, the Ninth Circuit's interpretation of loss causation cannot be reconciled

(Cont'd)
in denying leave to amend the SAC. (Pet. App. 14a-16a). Because the court of appeals held that respondents had sufficiently pleaded loss causation by alleging artificial inflation at the time of purchase, respondents' potential amendments to the SAC will not affect the loss causation issue. This petition concerns whether the Ninth Circuit's interpretation of loss causation is correct, and that question is squarely presented now. Because the majority of securities cases settle before reaching trial or a final disposition, refusal to review this issue based solely on the procedural posture of the case significantly decreases the chances that the issue will ever be resolved. *See* Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 Stan. L. Rev. 497, 525, 569 (Feb. 1991) (settlement rate for securities class actions is much higher than for civil litigation generally). Review by this Court therefore ought not be deferred until any later time. *See United States v. General Motors Corp.*, 323 U.S. 373, 377 (1945); *Gillespie v. United States Steel Corp.*, 379 U.S. 148, 153 (1964).

7. *See Semerenko v. Cendant Corp.*, 223 F.3d 165 (3d Cir. 2000); *Robbins v. Kroger Properties, Inc.*, 116 F.3d 1441 (11th Cir. 1997).

with the legislative history and plain language of the Reform Act. Notably, the Ninth Circuit's theory of loss causation is not practically viable in light of the Reform Act's explicit limitation on damages, which defines a plaintiffs' loss in terms of a post-transaction decline in stock price.

I. The Ninth Circuit Has Decided An Important And Recurring Issue Of Federal Securities Law – Loss Causation – In A Manner That Creates A Real And Intolerable Conflict Among The Circuits

The requirement of "loss causation" derives from the common law tort concept of "proximate causation" and, as such, has developed exclusively out of case law. The Reform Act codified that requirement. At least as early as 1981, in the seminal case of *Huddleston v. Herman & MacLean*, 640 F.2d 534, 549 (5th Cir. 1981), *aff'd in part, rev'd in part*, 459 U.S. 375 (1983), the loss causation requirement was found to be satisfied in securities fraud cases only if the misrepresentation touches upon the reasons for the investment's decline in value.[8] The majority of Circuits that have explicitly addressed loss causation, including the Second, Third, Seventh, and Eleventh, have adopted an interpretation similar to that set forth in *Huddleston*, while the Eighth and Ninth Circuits have applied a very different rule.

8. As the *Huddleston* court noted, "absent the requirement of causation, Rule 10b-5 would become an insurance plan for the cost of every security purchased in reliance upon a material misstatement or omission." *Huddleston*, 640 F.2d at 549.

A. Most Circuits Apply A Loss Causation Rule Different From That Applied By The Ninth Circuit Here

1. The Eleventh Circuit

The Eleventh Circuit has expressly acknowledged the conflict that exists among the Circuits regarding the interpretation and application of the loss causation requirement. In *Robbins v. Kroger Properties, Inc.*, 116 F.3d 1441 (11th Cir. 1997), the court of appeals addressed loss causation in a fraud-on-the-market case, with facts similar to those at issue here, wherein the misrepresentation was not disclosed to the public until more than one year after the drop in stock price. In *Robbins*, the plaintiffs presented evidence that an independent accounting firm made fraudulent statements about a company's financial status, which misled investors and artificially inflated the price at which investors purchased the company's stock. *Id.* at 1445-46.[9] The drop in stock price, however, occurred more than one year before the fraud was disclosed. *Id.* at 1445.

In a detailed analysis of loss causation, the Eleventh Circuit cited to decisions in both the Eighth and Ninth Circuits, acknowledging that in fraud-on-the-market cases, some courts have held that loss causation is established if the plaintiff can show that the price of stock on the date of purchase was inflated because of a misrepresentation. *Id.* at 1448 (citing *Knapp v. Ernst & Whinney*, 90 F.3d 1431, 1438 (9th Cir. 1996) and *In Re Control Data Corp. Securities*

9. To show that they relied on the accountant's misrepresentations, plaintiffs employed the fraud-on-the-market theory which presumes that the plaintiff class relied on an open, well-developed, and efficient market in purchasing their stock. *Id.* at 1446.

Litigation, 933 F.2d 616, 619-20 (8th Cir. 1991)). The court of appeals, however, expressly rejected the reasoning adopted in these Circuits, finding that their use of a presumption of reliance under the fraud-on-the-market hypothesis was more closely related to transaction causation than loss causation. *Id.* The court explained:

> Our cases have not utilized the [fraud-on-the-market] theory to alter the loss causation requirement, and we refuse to do so here. Our decisions explicitly require proof of a causal connection between the misrepresentation and the investment's subsequent decline in value.

Id. (*citing Huddleston*, 640 F.2d at 549). Because the plaintiffs were unable to show that the drop in stock price was related to the alleged misrepresentation, the court of appeals held that the plaintiffs had failed to satisfy the loss causation requirement. *Id.* at 1446, 1448-49.

Similar to the plaintiffs here, the plaintiffs in *Robbins* did not even attempt to link the alleged misrepresentations to any decline in the value of their investment. Instead, they simply claimed they paid too much. As the Eleventh Circuit concluded, where there is no connection between the alleged misrepresentation and a subsequent decline in stock price, a securities claim under Section 10(b) and Rule 10b-5 cannot survive because the essential element of loss causation cannot be established. *Id.* at 1448-49.

2. The Third Circuit

As the Ninth Circuit explicitly recognized, its decision is in conflict with the Third Circuit's application of loss causation at the pleading stage, which does "require a demonstration of a corrective disclosure followed by a stock price drop to be alleged in the complaint." (Pet. App. 9a n.4). In *Semerenko v. Cendant Corp.*, 223 F.3d 165 (3d Cir. 2000), plaintiffs, a class of investors, alleged that during a tender offer defendants made certain misrepresentations about Cendant that artificially inflated the price at which plaintiffs purchased shares of the company that Cendant was acquiring. In analyzing whether plaintiffs properly pleaded loss causation, the Third Circuit explained:

> Where the value of the security does not actually decline as a result of an alleged misrepresentation, it cannot be said that there is in fact an economic loss attributable to that misrepresentation. In the absence of a correction in the market price, the cost of the alleged misrepresentation is still incorporated into the value of the security and may be recovered at any time simply by reselling the security at the inflated price.

Id. at 172. Accordingly, the court of appeals confirmed that in order to satisfy the loss causation requirement at the pleading stage, a plaintiff must establish that the alleged misrepresentations proximately caused the decline in the security's value. *Id.* Because the plaintiffs had not only alleged that they purchased shares at an inflated price, but also alleged that the price of their stock declined when the corrective disclosure was made known to the public, the court concluded that the complaint alleged sufficient facts to establish loss causation. *Id.*

3. The Second Circuit

The Ninth Circuit's decision is also in direct conflict with the recent decision of the Second Circuit in *Emergent Capital Investment Mgt., LLC v. Stonepath Group, Inc.*, 343 F.3d 189 (2d Cir. 2003), wherein the court clarified its prior holding in *Suez Equity Investors, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87 (2d Cir. 2001). Up until this time, the Second Circuit's decision in *Suez Equity* had been interpreted by some courts as suggesting that loss causation could be pleaded with an allegation merely that the stock price was inflated at the time of purchase due to an alleged misrepresentation or omission.[10]

As the Second Circuit explained in *Emergent*, its decision in *Suez Equity* does not mean that alleging a disparity in investment value at the time of purchase is, by itself, sufficient to satisfy the loss causation pleading requirement. 343 F.3d at 198. Such an allegation, noted the court of appeals, amounts to nothing more than a paraphrased allegation of transaction causation. *Id.* "While it may explain why plaintiff purchased [the] stock, it does not explain why it lost money on the purchase, the very question that the loss causation allegation must answer." *Id.*

The Second Circuit acknowledged that in *Suez Equity* it did refer to a disparity between transaction price and true investment quality at the time of purchase and had also observed that the plaintiffs suffered a loss at the time of purchase since the value of their stock was less than represented by the defendants. *Id.* The court of appeals

10. *Suez Equity* was one of only three cases that the Ninth Circuit relied on in support of its interpretation of loss causation. (Pet. App. 9a).

explained, however, it did not mean to suggest that a purchase-time loss allegation alone could satisfy the loss causation requirement. *Id.* The court concluded, "[w]e do not think *Suez Equity* undermined our established requirement that securities fraud plaintiffs demonstrate a causal connection between the content of the alleged misstatements or omissions and 'the harm actually suffered.'" *Id.* at 199.

Based on the Second Circuit's opinion in *Emergent Capital*, it is clear that the Ninth Circuit's reliance on *Suez Equity* was misplaced.

4. The Seventh Circuit

Similarly, in *Bastian v. Petron Resources Corp.*, 892 F.2d 680 (7th Cir. 1990), *cert. denied*, 496 U.S. 906 (1990), the Seventh Circuit required securities plaintiffs to adequately plead loss causation in order to survive a motion to dismiss. In *Bastian*, plaintiffs were investors in certain oil and gas limited partnerships who claimed that had it not been for the misleading omissions and misrepresentations made by the defendants in their offering memoranda, plaintiffs would not have invested in the then worthless partnerships. *Id.* In granting defendants' motion to dismiss under Rule 12(b)(6), the district court held that the complaint failed to allege loss causation. *Id.* at 682.

In affirming the dismissal, the Seventh Circuit examined the roots of the loss causation requirement in federal securities fraud cases and noted its fundamental importance. "[I]t is an instance of the common law's universal requirement that the tort plaintiff prove causation." *Id.* at 683-684. The Seventh Circuit made clear that because

the plaintiffs' investments declined due to a general decline in the oil industry, the plaintiffs had not lost anything as the result of the defendants' alleged fraud. *Id.* at 685. The court of appeals found that to award damages where plaintiffs would have lost their investment regardless of the fraud, would result in a windfall. *Id.* In further explaining the significance of establishing loss causation in securities fraud cases, the court explained: "[n]o social purpose would be served by encouraging everyone who suffers an investment loss because of an unanticipated change in market conditions to pick through offering memoranda with a fine-tooth comb in the hope of uncovering a misrepresentation." *Id.*

B. Only The Eighth Circuit Agrees With The Ninth Circuit

The only Circuit with which the Ninth Circuit's interpretation of loss causation can logically be reconciled is the Eighth Circuit, which appears to accept the artificial price inflation theory in interpreting loss causation. In *In re Control Data Corp. Sec. Litig.*, 933 F.2d 616, 619-20 (8th Cir. 1991), the Eight Circuit held that in a fraud-on-the-market case, a plaintiff need only establish that a defendant's misrepresentations artificially inflated the price of the stock in order to satisfy the loss causation requirement. *See also Gebhardt v. Conagra Foods, Inc.*, 335 F.3d 824, 831 (8th Cir. 2003) (loss causation may be presumed in a fraud-on-the-market case if there is a pleading of price inflation caused by misrepresentations).

C. This Court Should Resolve The Conflict

The Ninth Circuit here has held that in a fraud-on-the-market case, a plaintiff can establish loss causation by simply positing that the stock's value at the time of purchase was artificially inflated as a result of the misrepresentation. This decision cannot be reconciled with the interpretation of loss causation adopted and applied in a majority of the other Circuits, particularly the Second, Third, Fifth, Seventh, and Eleventh, all of which have either implicitly or explicitly rejected the theory espoused by the Eighth and Ninth Circuits, requiring instead that a plaintiff demonstrate a causal connection between the alleged misrepresentation and the investment's subsequent decline in value.

Since the passage of the Reform Act in 1995, approximately 1,894 federal securities fraud class actions have been filed. Stanford Securities Class Action Clearinghouse, *available at http://securities.stanford.edu* (last modified Dec. 15, 2003). In nearly all of these cases, loss causation is an issue. As long as the conflict among the Circuits persists, the varying interpretations of loss causation will continue to pose fundamental problems for every federal securities fraud case filed, at the pleading stage and beyond.

Commentators confirm that the conflict among the Circuits regarding the interpretation of loss causation is a significant one – one that will continue to affect securities fraud cases nationwide until a uniform and consistent interpretation is adopted. *See* Sarah S. Gold & Leon P. Gold, *Clarifying the Pleading of Loss Causation: A direct causal link between the alleged misrepresentation or omission and the economic loss suffered must be demonstrated*, 230 N.Y. L.J. 3, Oct. 8, 2003 at Col. 1 (noting that the conflict among the Circuits regarding

the interpretation of loss causation may ultimately need to be addressed by the Supreme Court); David M. Brodsky & Jeff G. Hammel, *The Fraud on the Market Theory and Securities Fraud Claims*, 230 N.Y. L.J. 4, Oct. 24, 2003, at Col. 4 (criticizing the Ninth Circuit's interpretation of loss causation as expanding the fraud-on-the-market theory to provide plaintiffs a rebuttable presumption of both transaction and loss causation); Note, *A Winning Approach to Loss Causation Under Rule 10b-5 in Light of the Private Securities Litigation Reform Act of 1995 ("PSLRA")*, 68 Fordham L. Rev. 1781, 1782 (April 2000) (providing a detailed analysis of the split among Circuits in interpreting the loss causation requirement, as well as the legislative history of the Reform Act's codification of loss causation). As the division among the Circuits appears only to be getting wider, review by this Court is now appropriate.

II. The Ninth Circuit's Interpretation Of Loss Causation Cannot Be Squared With The Text Of The Reform Act

Through the Reform Act, Congress sought, in part, to establish uniform and stringent pleading requirements in securities fraud actions arising under Section 10(b) of the Securities Exchange Act of 1934. Specifically, Section 21D(b)(4) of the Reform Act, provides that "the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this title caused the loss for which the plaintiff seeks to recover damages." 15 U.S.C. § 78u-4(b)(4) (reproduced at Pet. App. 54a).

Uniform and meaningful application of the loss causation element is particularly important at the pleading stage because it is critical to fulfilling Congress' goal of imposing consistent

and more stringent pleading requirements. If plaintiffs cannot allege a causal nexus between the purported misrepresentation or omission and an investment's subsequent decline in value, the lawsuit should not proceed.

As required by the Reform Act, a plaintiff who brings a securities fraud claim has the burden of proving that the alleged fraud of the defendant caused the loss for which the plaintiff seeks to recover damages. The Ninth Circuit's interpretation of loss causation essentially renders the Reform Act's codification of loss causation meaningless. Under the Ninth Circuit's holding, shareholders do not need to prove – or even allege – that the corporate conduct on which their claim is based caused a drop in their stock price. Instead, all they need to do is claim the price at which they purchased the shares was artificially inflated because of the alleged fraud. This has serious implications. Loss causation ensures the existence of an identifiable nexus between a defendant's alleged misconduct and plaintiff's claimed losses. Consequently, it allows courts to take account of intervening factors, such as war or a recession, that may have caused the price to decline, in deciding whether and to what extent to hold a defendant in a securities fraud case liable.

In addition to codifying loss causation in the Reform Act, Congress also implemented therein an upward damages limitation in order to confine a plaintiff's recovery to those losses actually caused by the fraud and not by other market conditions which defendants did not cause. Specifically, Section 21D(e)(1) of the Reform Act provides:

> Except as provided in paragraph (2), in any private action arising under this chapter in which the plaintiff seeks to establish damages by reference

> to the market price of a security, the award of damages to the plaintiff shall not exceed the difference between the purchase or sale price paid or received, as appropriate, by the plaintiff for the subject security and the mean trading price of that security during the 90-day period beginning on the date on which *the information correcting the misstatement or omission that is the basis for the action is disseminated to the market*.

15 U.S.C. § 78u-4(e)(1) (emphasis added) (reproduced at Pet. App. 54a-55a). This provision of the Reform Act has been referred to as the "look back" provision. In defining a plaintiff's damages in a Section 10(b) securities case, this provision not only restricts the plaintiff's recovery to the amount of the post-transaction decline in value, but it also implicitly assumes that a corrective disclosure of the alleged misrepresentation or omission caused such a decline.[11]

The Ninth Circuit's interpretation of loss causation, which is based solely on a theory of price inflation at the time of purchase, is simply not practical in light of the Reform Act's "look back" provision. Under the Ninth Circuit's holding, a plaintiff can establish loss causation merely by alleging that the stock was artificially inflated as the result of defendant's fraud, but cannot recover damages if the stock price does not actually decline, or if it declines but rebounds within the 90-day "look back" period. Similarly, the plaintiffs here would not be entitled to any damages, even though in

11. In this regard, the interpretation of loss causation adopted in the Second, Third, Fifth, Seventh and Eleventh Circuits is consistent with the text of the Reform Act, in that they require plaintiffs to establish a causal connection between the alleged fraud and a subsequent decline in stock price.

the Ninth Circuit's view they adequately pleaded loss causation. Pursuant to the "look back" provision, damages are measured beginning on the day the corrective disclosure is made to the public. Here, the loss for which plaintiffs seek to recover is the stock price decline that occurred on February 24, 1998. However, the ostensible "corrective disclosure" relating to Albuterol Spiros was not made until November 3, 1998 – nine months after the close of the Class Period.[12] Congress could not possibly have intended such an absurd inconsistency between the loss causation requirement and the "look back" provision governing damages.

Although the "look back" provision does not explicitly require a plaintiff to prove that the defendant's fraud caused the post-transaction loss, requiring such a causal connection is implicit. Indeed, it is necessary in order for the damages provision to have any practical effect. If a defendant's fraud did not cause the post-transaction decline, it would make no sense to allow the plaintiff to use it as evidence for damages. Moreover, as noted by the Banking, Housing and Urban Affairs Committee of the United States Senate, by including the limitation on damages provision in the Reform Act, the Committee intended to rectify the uncertainty in calculating damages in securities fraud cases, "thereby limiting damages to those losses caused by the fraud and not other market conditions." S. Rep. No. 104-98 at 20 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 699.

---

12. Interestingly, following the corrective disclosure relating to Albuterol Spiros, Dura's stock dropped from $12.375 on November 3, 2003 to $9.75 on November 4, 2003. SER, 79, Exh. L. However, twelve trading days later, its stock price closed at $12.438. *Id.* Ninety days later, at the end of the statutory "look back" period, Dura's stock price closed at $14.00, hitting a high during this period of $16.00. *Id.* Presumably, this escalation in share price prompted plaintiffs to end the Class Period on February 24, 1998, rather than November 3, 1998.

Collectively, the legislative history of the Reform Act, its codification of loss causation, and its "look back" provision provide a solid basis for developing a uniform approach to loss causation – one that requires a plaintiff to plead and prove a causal connection between the defendant's alleged misrepresentation or omission and the investment's subsequent decline in value. By removing the causal nexus that Congress intended to require, the Ninth Circuit's interpretation of loss causation frustrates the effective administration of the Reform Act and renders meaningless or superfluous several of its provisions. Because loss causation is an issue of nationwide application, immediate review by this Court is warranted.

CONCLUSION

For the foregoing reasons, the petition for a writ of *certiorari* should be granted.

Respectfully submitted,

WILLIAM F. SULLIVAN
Counsel of Record
CHRISTOPHER H. MCGRATH
TRACEY L. DELANGE
PAUL, HASTINGS, JANOFSKY
& WALKER LLP
3579 Valley Centre Drive
San Diego, CA 92130
(858) 720-2500

Attorneys for Petitioners

APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT DATED AND FILED AUGUST 5, 2003

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 01-57136

MICHAEL BROUDO; BALDEV S. GILL; LARRY MORGAN IRA; LEONID SHVARTSMAN, (for G&S partnership); NEIL SISKIND; ROBERTA SPECK; BRENT VOGT, on behalf of themselves and all others similarly situated,

Plaintiffs-Appellants,

v.

DURA PHARMACEUTICALS, INC.; CAM L. GARNER; JAMES W. NEWMAN; CHARLES W. PRETTYMAN; WALTER F. SPATH; JAMES C. BLAIR; JULIA R. BROWN; JOSEPH C. COOK, JR.; MITCHELL R. WOODBURY; MERILL LYNCH AND CO./MERRILL LYNCH, PIERCE FENNER AND SMITH, INC.; NISSAN MOTOR CO., a Japanese corporation,

Defendants-Appellees.

February 4, 2003, Argued and Submitted,
Pasadena, California
August 5, 2003, Filed

Appendix A

Before: Harry Pregerson, Stephen Reinhardt, and Glenn L. Archer, Jr.,* Circuit Judges.

ARCHER, Senior Circuit Judge:

Michael Broudo et al. ("Appellants") appeal the district court's dismissal with prejudice of the second amended complaint ("SAC") under Federal Rule of Civil Procedure ("FRCP") 12(b)(6). *In re Dura Pharm., Inc. Sec. Litig.*, No. 99CV0151-L(NLS) (S.D. Cal. Nov. 11, 2001). Because 1) the SAC satisfied the loss causation element of a Section 10(b) violation of the Securities and Exchange Act of 1934 with respect to the Albuterol Spiros device; and 2) the district court abused its discretion in not permitting Appellants to amend the SAC to include additional allegations regarding Dura's Ceclor CD sales, the district court's judgment is reversed and remanded.

BACKGROUND

This securities fraud case is a class action on behalf of investors who purchased Dura Pharmaceutical securities between April 15, 1997, and February 24, 1998 ("the class period"). This appeal is drawn specifically to alleged misleading and untrue statements made by Dura and its officials (collectively "Dura")[1] about Dura's Albuterol Spiros

* The Honorable Glenn L. Archer, Jr., Senior Circuit Judge, United States Court of Appeals for the Federal Circuit, sitting by designation.

1. Dura is a San Diego-based developer and marketer of prescription pharmaceutical products for the treatment of allergies, asthma, and related respiratory condition.

Appendix A

delivery device for asthma medication[2] and Dura's Ceclor CD antibiotic. During the class period, Dura issued several press releases[3] indicating satisfactory development and testing of the Albuterol Spiros Device and claiming rising sales of Ceclor CD, both of which Appellants allege were known to Dura and the individual defendants to be untrue. The most relevant statements are the following:

April 15, 1997 Press Release commenting on better-than-expected first quarter results: "Dura . . . announced that revenues and net income for the first quarter more than doubled over the same period last year." This press release also quoted a Dura official as stating that he was "very pleased with the first quarter results" and that "we are happy with the strong progress made in selling our new respiratory antibiotic Ceclor CD." The release further stated that "Patient dosing was completed for clinical trials needed for NDA (new drug application) submission of Spiros albuterol. . . ." (SAC ¶ 56)

June 5, 1997 Press Release: "Dura . . . announced the completion of the clinical trials necessary for a new drug application (NDA) submission for the Albuterol Spiros product. . . ." "We are pleased with the results to date and

2. The Albuterol Spiros system is a device used to dispense asthma medication which does not make it imperative that the patient inhale at the exact time the medicine is dispensed.

3. Other statements offered by Appellants are those made by analysts purporting to report what various Dura officials had told them. However, the complaint does not clearly attribute any of these comments to Dura officials, and they are not discussed further.

are preparing the NDA for filing in the latter half of this year." (SAC ¶ 79)

July 15, 1997 Press Release commenting on better-than-expected Q2 results: "We are pleased with Dura's performance in the second quarter of 1997. Ceclor CD . . . ha[s] been well received by physicians who are responding favorable to our promotional efforts. . . . We completed clinical trials necessary for NDA (new drug application) submission and are on track to file the Albuterol Spiros NDA on behalf of Spiros Corp. in the second half of 1997." (SAC ¶ 85)

October 14, 1997 Press Release, commenting on better-than-expected Q3 results: "Dura . . . today reported record earnings for both the third quarter and nine months year-to-date of 1997, compared to the same periods last year. . . . Pharmaceutical sales growth is principally attributable to the impact of new product acquisitions and introductions, such as Ceclor CD. . . ." (SAC ¶ 111)

November 10, 1997 Press Release, announcing submission of NDA: "Dura . . . today announced that it has submitted a new drug application (NDA) with the FDA for Albuterol Spiros." (SAC ¶ 123)

January 20, 1998 Press Release, commenting on better-than-expected Q4 results: "Dura reported record revenues . . . for the quarter and the full year. . . . 'During the past year we significantly strengthened both the pharmaceutical product marketing and the Spiros development arms of our business . . . We have continued to demonstrate our capabilities as a respiratory marketing force as shown by the

growth of our Ceclor CD market share . . . from 8% at the beginning of 1997 to 25% by year-end.' " (SAC ¶ 128)

In the class period, Dura's stock reached a high of $53 per share. On the last day of the class period, February 24, 1998, Dura revealed that it expected lowerthan-forecast 1998 revenues and 1998 earnings per share ("EPS") due to, *inter alia*, slower-than-expected sales of Ceclor CD. Dura's stock then dropped from $39 1/8 on February 24, 1998, to $20 3/4 on February 25, 1998, a 47% one-day loss. Throughout the remainder of 1998, Dura's business declined. In an April 16, 1998 conference call with stock analysts, Dura revealed that as early as December 1997, wholesale channels had been clogged with many months of excess inventory and that actual sales of several products, including Ceclor CD, had in fact been declining. Later, in November 1998, Dura also revealed that the FDA found the Albuterol Spiros device not approvable due to electro-mechanical reliability issues and chemistry, manufacturing, and control concerns.

Appellants filed several class actions alleging violations of sections 10(b) and 20(a) of the Securities and Exchange Act and Rule 10b-5 promulgated by the Securities Commission, which, in due course, were consolidated. The district court granted Dura's motion to dismiss the Consolidated and Amended Complaint but dismissed it without prejudice. In doing so, the court instructed the Appellants as follows:

> The amended complaint shall comply with Federal Rule of Civil Procedure 8, and concisely set forth each allegedly false or misleading statement or

> omission, and follow each statement or omission with the specific reasons why the statements were false when made or why the Defendants had a duty to disclose. In addition, the Plaintiffs shall specify which Defendants made the statements and knew the "true facts" that should have been disclosed.

In re Dura Pharmaceuticals, Inc. Securities Litigation, 2000 U.S. Dist. LEXIS 15258, No. 99cv0151-L(NLS) Slip op. at 26 (S.D. Cal. Jul. 12, 2000). Appellants subsequently filed the SAC which the district court also dismissed, this time, however, with prejudice.

With respect to the Albuterol Spiros device, the district court found that Appellants had not properly pled the loss causation element of a 10(b) violation. Specifically, the district court focused on the last day of the class period—February 28, 1998—and Dura's revelation that day which led to the large drop in stock price:

> The SAC does not contain any allegations that the FDA's non-approval [of the Albuterol Spiros device] had any relationship to the February price drop. Accordingly, the SAC does not explain how the alleged misrepresentations and omissions regarding Albuterol Spiros "touched" upon the reasons for the decline in Dura's stock price. Rather, the decline in Dura's stock price was the result of an expected revenue shortfall. Accordingly, the SAC's allegations regarding Albuterol Spiros are insufficient to state a claim.

In re Dura Pharm., 2000 U.S. Dist. LEXIS 15258, slip op. at 15. The district court reasoned further that because the February 24 announcement did not mention the Albuterol Spiros device, any omissions or misleading statements about this device could not be said to have caused the decline in price. Therefore, the district court ruled that the loss causation element was not met.

Turning to Dura's statements regarding Ceclor CD sales made during the class period, the district court found that Appellants' allegations in the SAC were not sufficient to indicate that these statements were false and made with knowledge of their falsity. *Id.* 2000 U.S. Dist. LEXIS 15258, at 20. The district court therefore held that the allegations in the SAC were not sufficient to withstand a motion to dismiss based on the scienter requirement for a § 10(b) violation. *Id.*

The district court then dismissed the complaint with prejudice "[b]ecause the Plaintiffs have had an opportunity to amend the complaint to meet the pleading requirements under the PSLRA and *Silicon Graphics*." *Id.* 2000 U.S. Dist. LEXIS 15258, at 23. This appeal followed, and we have jurisdiction under 28 U.S.C. § 1291.

DISCUSSION

A complaint's dismissal under FRCP 12(b)(6) is reviewed *de novo*. *See Howard v. Everex Sys.*, 228 F.3d 1057, 1060 (9th Cir. 2000). And on review, the court must accept the complaint's well-pleaded allegations as true and construe them in the light most favorable to the plaintiff. *See In re Silicon Graphics Sec. Litig.*, 183 F.3d 970, 983 (9th Cir. 1999). A district court's denial of leave to amend is reviewed

for abuse of discretion. *See In re Vantive Corp. Sec. Litig.*, 283 F.3d 1079, 1097 (9th Cir. 2002).

In order for plaintiffs to properly allege a claim brought under § 10(b) of the Securities Exchange Act of 1934, they must state the following: (1) defendants made a false statement or omission with regard to a material fact; (2) in connection with the purchase or the sale of a security; (3) with scienter; (4) upon which plaintiffs reasonably relied; and (5) that proximately caused the alleged loss. *See Binder v. Gillespie*, 184 F.3d 1059, 1063 (9th Cir. 1999).

Loss Causation

"The causation requirement in Rule 10b-5 securities fraud cases includes 'both transaction causation, that the violations in question caused the plaintiff to engage in the transaction, and loss causation, that the misrepresentations or omissions caused the harm.' " *Id.* at 1065 (*quoting McGonigle v. Combs*, 968 F.2d 810, 820 (9th Cir. 1992)). In this circuit, loss causation is satisfied where "the plaintiff shows that 'the misrepresentation touches upon the reasons for the investment's decline in value.' " *Id.* at 1066 (*quoting McGonigle*, 968 F.2d at 821); *accord Provenz v. Miller*, 102 F.3d 1478, 1492 (9th Cir. 1996); *Binder*, 184 F.3d 1059 at 1066 (9th Cir. 1999).

This "touches upon" language is admittedly ambiguous. *See Binder*, 184 F.3d at 1066 (stating that the "loss causation requirement in this circuit and others has been less than clear"); *Knapp v. Ernst & Whinney*, 90 F.3d 1431, 1438 (9th Cir. 1996) (stating "[a]lthough there may be other acceptable formulations of this [loss causation] element, the

[trial] court's instruction was proper"). Our cases have held, however, that: "[i]n a fraud-on-the-market case, plaintiffs establish loss causation if they have shown that the price on the date of purchase was inflated because of the misrepresentation." *Knapp*, 90 F.3d at 1438 (emphasis added) (*citing Gray v. First Winthrop Corp.*, 82 F.3d 877, 886 (9th Cir. 1996)); *see also Gebhardt v. ConAgra Foods, Inc.*, 335 F.3d 824, 2003 U.S. App. LEXIS 13257, at *18 (8th Cir. June 30, 2003) ("[P]laintiffs were harmed when they paid more for the stock than it was worth. This is a sufficient allegation."); *Equity Investors, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87, 97-98 (2d Cir. 2001) ("[P]laintiffs may allege transaction and loss causation by averring both that they would not have entered the transaction but for the misrepresentations and that the defendants' misrepresentations induced a disparity between the transaction price and the true 'investment quality' of the securities *at the time of transaction.*") (emphasis added). Accordingly, for a cause of action to accrue, it is not necessary that a disclosure and subsequent drop in the market price of the stock have actually occurred, because the injury occurs at the time of the transaction. *See Gray*, 82 F.3d at 886; *Knapp*, 90 F.3d at 1438. It is at that time that damages are to be measured. Thus, loss causation does not require pleading a stock price drop following a corrective disclosure or otherwise. It merely requires pleading that the price at the time of purchase was overstated and sufficient identification of the cause.[4]

4. By contrast, other circuits are less favorable to plaintiffs and do require demonstration of a corrective disclosure followed by a stock price drop to be alleged in the complaint. *See, e.g., Semerenko v. Cendant Corp.*, 223 F.3d 165 (3d Cir. 2000) ("Where the value of

(Cont'd)

Here the district court found that Appellants' allegations in the SAC regarding the Albuterol Spiros device were insufficient to state a claim of securities fraud because they did not explain how the loss causation element was satisfied. Specifically, the court found "[t]he SAC does not contain any allegations that the FDA's non-approval [of the Albuterol Spiros device] had any relationship to the February price drop. Accordingly, the SAC does not explain how the alleged misrepresentations and omissions regarding Albuterol Spiros 'touched' upon the reasons for the decline in Dura's stock price." *Dura Pharm.*, 2000 U.S. Dist. LEXIS 15258, slip op. at 15. This reasoning presumes that the loss causation element requires a demonstration of a corrective disclosure followed by a stock price drop during the class period and that those facts must be alleged in the complaint. As we explain, it is necessary in the pleading to allege 1) that the stock's price at the time of purchase was overstated and 2) sufficient identification of the cause for this overvaluation. Appellants have pled that the price of the stock was overvalued in part due to the misrepresentations by Dura and the individual defendants that the development and testing of the Albuterol

---

(Cont'd)

the security does not actually decline as a result of an alleged misrepresentation, it cannot be said that there is in fact an economic loss attributable to that misrepresentation. In the absence of a correction in the market price, the cost of the alleged misrepresentation is still incorporated into the value of the security and may be recovered at any time simply by reselling the security at the inflated price."); *Robbins v. Kroger Properties, Inc.*, 116 F.3d 1441, 1448 (11th Cir. 1997) ("Our decisions explicitly require proof of a causal connection between the misrepresentation and the investment's subsequent decline in value.")

Spiros device were proceeding satisfactorily and that FDA approval of the device was imminent. Accordingly, the district court erred by finding that appellants failed to plead loss causation sufficient to survive a motion to dismiss with regard to statements concerning the Albuterol Spiros device.

Scienter

The pleading requirements for securities fraud actions are articulated in the Private Securities Litigation Reform Act of 1995 ("PSLRA"). First, the complaint must "specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed." 15 U.S.C. §§ 78u-4(b)(1) (2000). The second requirement of the PSLRA is that the plaintiff plead "with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. §§ 78u-4(b)(2) (2000).

This court recently summarized the scienter requirement: "The complaint must allege that the defendant made false or misleading statements either intentionally or with deliberate recklessness or, if the challenged representation is a forward looking statement, with 'actual knowledge . . . that the statement was false or misleading.' " *In re Vantive Sec. Litig.*, 283 F.3d 1079, 1085 (9th Cir. 2002). Accordingly, "[w]here pleadings are not sufficiently particularized or where, taken as a whole, they do not raise a 'strong inference' that misleading statements were knowingly or deliberate recklessness [sic] made to investors, a private securities fraud

complaint is properly dismissed under Rule 12(b)(6)." *Ronconi v. Larkin*, 253 F.3d 423, 429 (9th Cir. 2001). We must decide whether the Appellants met this scienter requirement with regard to their allegations concerning Dura's Ceclor CD sales.

At issue are statements made by Dura reporting increased market share of Ceclor CD and expressing optimism with respect to Ceclor CD's future results. Specifically, the SAC alleges that Dura made misrepresentations that sales of Ceclor CD had been positive throughout the year when it issued statements indicating that Dura was "pleased" with the sales results of various quarters and that the company was "happy" with the strong progress made in selling Ceclor CD throughout the year. (SAC ¶¶ 56, 85, 111, 128). Appellants allege that these statements were false or misleading because sales of Dura's major drug products were flat or declining, particularly Ceclor CD, with actual sales to consumers dropping throughout the class period. (SAC ¶ 58(a)). Appellants further allege that the defendants knew of these declining sales through specialized reports which compared actual versus planned sales of Dura's drug products. (SAC ¶ 62) Thus, the defendants were kept apprised of Dura's drug sales and knew that such sales were below plan and insufficient for Dura to achieve continued growth in sales and earnings. (SAC ¶ 62).

To support the allegations that Dura was aware of the falsity of the favorable statements, Appellants further allege Dura and the individual defendants engaged in insider trading, raised capital through a stock offering, and engaged in "channel stuffing" (the premature pushing of product into the wholesale channels to artificially inflate sales):

> [i]n order to cover up the sales shortfalls . . . Dura was engaging in a subterfuge to artificially inflate its revenues and EPS by shipping excessive amounts of Ceclor CD and other products to wholesalers, who were enticed to take the product by price discounts, extended payment terms and/or other incentives. As a result, Dura's Ceclor CD and other product inventories in the distribution channel were greatly in excess of the normal one-month supply. As a result of this practice, Dura's Ceclor CD sales were artificially inflated and Dura's insiders knew that as a result of "borrowing" millions of dollars of sales of Ceclor CD from future periods, Dura's sales of Ceclor CD would fall sharply once this practice stopped.

(SAC ¶ 58(d)).

The district court discussed each of these allegations separately and concluded that each was insufficient to show scienter. As explained above, the pleading requirement for the element of scienter in a securities fraud case is high. The existence of reports that showed Ceclor CD sales were below internal projection and Dura's knowledge of these reports, coupled with Dura's statements that it was pleased with sales figures, are not specific facts that strongly suggest actual intent by Dura to mislead investors. In fact, Dura's internal expectations could have been aggressive and falling short of them may have been anticipated. Further, while unusual stock or suspicious stock sales can serve as circumstantial inference of scienter, *see In re Silicon Graphics*, 183 F.3d at 986, the allegations of insider trading

in the SAC do not indicate that the individual defendants' trading practices were dramatically out of line with their prior trading activities. Turning to the "channel stuffing" allegations, as the district court explained, channel stuffing claims may have some probative value insofar as the channel stuffing was done so as to artificially inflate income, but there may also be other legitimate reasons for attempting to achieve sales earlier. We see no fault with the district court's conclusion that here the allegation of channel stuffing was insufficient for scienter.

While the district court did a detailed analysis of the Appellants' separate arguments for scienter, its task was not complete. This court has made clear that allegations of scienter must be collectively considered: "Beyond each individual allegation we also consider 'whether the total of plaintiffs' allegations, even though individually lacking, are sufficient to create a strong inference that defendants acted with deliberate or conscious recklessness.' " *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp.*, 320 F.3d 920, 938 (9th Cir. 2003) (quoting *Lipton v. Pathogenesis Corp.*, 284 F.3d 1027, 1038 (9th Cir. 2002)) (emphasis added). Accordingly, we must vacate the district court's finding of no scienter. On remand the district court should perform the final step of considering the Appellants' allegations collectively when conducting its scienter analysis.[5]

---

5. We express no opinion as to whether the allegations in the SAC in totum rise to the level necessary for scienter. Indeed, this would be premature because of our decision that Appellants should be permitted to amend the complaint (see below), which may result in additional scienter allegations.

Leave to Amend

Finally, Appellants assert they should have been granted the opportunity to amend the SAC. Leave to amend under FRCP 15 is to be liberally applied. Where the plaintiff offers to provide "additional evidence" that would add "necessary details" to an amended complaint and such offer is made in good faith, leave to amend should be granted. *See Eminence Capital v. Aspeon, Inc.*, 316 F.3d 1048, 1053 (9th Cir. 2003) (holding that the district court erred in not granting leave to amend the complaint in a securities fraud case in order for plaintiffs to meet the scienter requirement of the PSLRA). Specifically, "[d]ismissal with prejudice and without leave to amend is not appropriate unless it is clear on *de novo* review that the complaint could not be saved by amendment." *Id.* at 1052.

With respect to Ceclor CD sales, Appellants seek to amend the SAC to include, *inter alia*, statements by a confidential witness who has direct knowledge that at least two of the defendants discussed how they could make stock analysts "perceive" that Dura was doing better than it actually was and that one of the defendant's oft-stated catch phrase to employees who questioned his tactics was "let 'em catch us." Such allegations are the type that could demonstrate a strong inference that Dura knowingly or with deliberate recklessness made false or misleading statements to investors. Accordingly, we cannot say that the SAC could not be saved by amendment.

Appendix A

Because it appears that Appellants had a reasonable chance of successfully stating a claim if given another opportunity, the district court abused its discretion in denying leave to amend the SAC.[6]

CONCLUSION

Dura invites us to affirm the district court's judgment based on issues not decided by the district court. Specifically, Dura asserts that the alleged misleading statements are not actionable because they are protected by the safe harbor and bespeaks caution doctrines, that non-speaking defendants cannot be liable under section 10(b), and that Appellants failed to plead "all facts" to support their "information and belief" allegations. While Dura is correct that we may affirm the district court's judgment on a different ground, we need not do so. Indeed, we usually do not. *See Andersen v. Cumming*, 827 F.2d 1303, 1305 (9th Cir. 1987) (stating "[o]rdinarily we will not decide an issue that was not addressed by the district court") (citing *Greater Los Angeles Council of Deafness v. Zolin*, 812 F.2d 1103, 1107 (9th Cir. 1987)). We decline Dura's invitation for this reason. Further, because we are granting Appellants leave to amend the SAC, Dura's "other" arguments may be mooted by such amendment. Accordingly, it would be improper for us to rule on those issues.

---

6. Additionally, Appellants seek to amend the SAC by alleging the contents of specific conversations between confidential witnesses and Dura insiders which would further corroborate the allegations concerning the Albuterol Spiros device. We see no reason to limit amendments to the SAC to allegations concerning Ceclor CD sales.

Appendix A

We hold Appellants have sufficiently pled loss causation to survive a motion to dismiss with regard to statements concerning the Albuterol Spiros device. Additionally, Appellants have shown that they should have been granted leave to amend the SAC. Therefore, the judgment of the district court is

REVERSED AND REMANDED.

APPENDIX B — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF CALIFORNIA DATED NOVEMBER 2, 2001

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

Civil No. 99cv0151-L(NLS)

IN RE DURA PHARMACEUTICALS, INC.
SECURITIES LITIGATION,

This Document Relates to: All Actions

ORDER GRANTING DEFENDANTS' MOTION TO DISMISS AND DISMISSING SECOND CONSOLIDATED AND AMENDED COMPLAINT WITH PREJUDICE

[Docket No. 75]

This matter came on regularly for a hearing on Defendants' motion to dismiss the Second Consolidated Amended Complaint ("SAC"). Henry Rosen and Tor Gronborg of Milberg Weiss Bershad Hynes & Lerach LLP, and Alan Schulman of Bernstein Litowitz Berger & Grossman, LLP appeared for the Plaintiffs. William F. Sullivan, Christopher H. McGrath, and Sean T. Prosser of Brobeck, Phleger & Harrison, LLP appeared for the Defendants.

FACTUAL BACKGROUND

Plaintiffs bring this action on behalf of purchasers of shares of Dura Pharmaceuticals, Inc. ("Dura" or the "Company")

Appendix B

securities from April 15, 1997 to February 24, 1998 ("Class Period"). (Second Consolidated Amended Complaint ("SAC") ¶ 1.) Dura is a San Diego-based developer and marketer of prescription pharmaceutical products for the treatment of allergies, asthma, and related respiratory conditions. (SAC ¶ 48.) The Individual Defendants held the following positions at Dura during the Class Period: Cam L. Garner ("Garner") was President, Chief Executive Officer and Chief Operations Officer and Chairman; James W. Newman ("Newman") was Senior Vice President-Finance & Administration and Chief Financial Officer; Charles W. Prettyman ("Prettyman") was Senior Vice President-Development and Regulatory Affairs; Walter F. Spath ("Spath") was Senior Vice President-Sales & Marketing; Mitchell R. Woodbury ("Woodbury") was Senior Vice President/General Counsel; Julia R. Brown ("Brown") was Senior Vice President-Business Development and Planning; and Joseph C. Cook ("Cook") was a director (these defendants are referred to collectively as "Individual Defendants"). (SAC ¶ 49.)

Dura became a publicly-traded company in 1992, pursuing a business strategy of marketing niche pharmaceutical drugs. (SAC ¶ 1.) At that time, Dura typically purchased the rights to market drugs developed by large pharmaceutical companies that were approaching the end of their profitability to those companies. *Id.* By 1995, Dura's management realized that given the Company's size, it would be increasingly difficult to achieve continued revenue and earnings per share ("EPS") growth solely by acquiring marketing rights to niche drugs. *Id.* Therefore, Dura insiders decided to diversity its business, and become a medical device development company and develop its own proprietary drug products. *Id.* In 1995, Dura

began developing the Spiros drug delivery system for Albuterol ("Albuterol Spiros" or "Spiros drug delivery system"), a method of aerosolizing powders so that asthma medicines, including Albuterol, could be inhaled. (SAC ¶ 2.) This system purportedly would have advantages over existing inhalers that depended on the user to successfully coordinate the use of the inhaler and inhalation of the medication. *Id.*

Dura's insiders created Spiros Development Corporation ("Spiros I") to incur Dura's costs of developing the Spiros drug delivery system. (SAC ¶ 4.) In addition, while phase III clinical trials of Albuterol Spiros were being completed, Defendants were taking steps to complete a major debt offering. (SAC ¶ 18.) According to Plaintiffs, the creation of Spiros I, the debt offering, and the Individual Defendants' concern over the value of their stock options and cash bonuses pushed Defendants to drive up the price of Dura's stock and keep it at high levels. (SAC ¶¶ 5, 19-20.) To this end, Plaintiffs contend that beginning in April 1997 and continuing through the Class Period, Defendants began a "concerted campaign to falsely persuade investors that Dura's sales were increasing and that Dura was successfully completing the development and clinical trials of the Spiros drug delivery system." (SAC ¶ 21.) Plaintiffs maintain Defendants engaged in improper revenue recognition, misrepresented the effectiveness of its sales force, and misrepresented and omitted material information about the development of Albuterol Spiros. (SAC ¶¶ 21-31.) Plaintiffs also contend that during the Class Period, the Individual Defendants engaged in suspicious insider trading, selling 188,626 shares for over $7.3 million between May 12, 1997 and July 22, 1997. (SAC ¶¶ 24, 37, 154-70.)

During the Class Period, Dura's stock reached a high of $53 per share. (SAC ¶ 37.) On the last day of the Class Period, February 24, 1998, Dura revealed that it expected lower than forecast 1998 revenues and 1998 EPS due to slower-than-expected sales of the Ceclor CD and Nasarel/Nasalide product lines, and to the decision to increase the size of its sales force from 270 to over 450 to try to boost sales of existing products. (SAC ¶¶ 32, 134.) Dura's stock thereafter dropped from $39 1/8 on February 24, 1998, to $20 3/4, on February 25, 1998, an 18 3/8 point, 47% one-day decline on a volume of 32 million shares. (SAC ¶¶ 32, 134.) During the balance of 1998, Dura's business declined. (SAC ¶¶ 34, 135.) In an April 16, 1998, conference call Dura revealed that at least by December 1997, the wholesale channels had been clogged with many months of excess inventory, and that sales of several products were declining. (SAC ¶¶ 34, 135.) Dura also stated that its sales force was inadequate and had been plagued by very high turnover, and as a result, contributing to the poor sales of its drug products. (SAC ¶¶ 34, 135.) In November 1998, Dura revealed that the FDA had found that Albuterol Spiros was not approvable due to electro-mechanical reliability issues and chemistry, manufacturing, and control concerns. (SAC ¶¶ 33, 136.) Ultimately, Dura abandoned its efforts to obtain FDA approval of Albuterol Spiros. (SAC ¶¶ 35, 136.) Also after the Class Period, Dura attempted to form an affiliate company (DJ Pharma) to co-promote the Rondec product line it had acquired from Abbott Laboratories on June 30, 1995 for $35 million. (SAC ¶ 145). But by December 1998 the transaction was not finalized and Dura had to reconsolidate DJ Pharma back into Dura. (SAC ¶ 145.) At some point thereafter, Dura took a $28 million charge for the impairment of Rondec. *Id.*

Appendix B

Plaintiffs filed several class actions alleging violations of sections 10(b) and 20(a) of the Securities and Exchange Act and Rule 10b-5 promulgated by the Securities and Exchange Commission. The cases were consolidated into the instant case number. By order dated July 12, 2000, this Court granted the Defendants' motion to dismiss the Consolidated and Amended Complaint, and dismissed the pleading without prejudice. Plaintiffs subsequently filed the SAC that is the subject of the instant motion.

DISCUSSION

I. Applicable Law Regarding Motions to Dismiss Securities Fraud Complaints.

A motion to dismiss under Federal Rule of Civil Procedure 12(b)(6) tests the sufficiency of the complaint. *Navarro v. Block*, 250 F.3d 729, 732 (9th Cir. 2001). Dismissal of a claim under this Rule is appropriate only where "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957); *Navarro*, 250 F.3d at 732. Dismissal is warranted under Rule 12(b)(6) where the complaint lacks a cognizable legal theory. *Robertson v. Dean Witter Reynolds, Inc.*, 749 F.2d 530, 533-34 (9th Cir. 1984); *see Neitzke v. Williams*, 490 U.S. 319, 326-27 (1989) ("Rule 12(b)(6) authorizes a court to dismiss a claim on the basis of a dispositive issue of law."). Alternatively, a complaint may be dismissed where it presents a cognizable legal theory yet fails to plead essential facts under that theory. *Robertson*, 749 F.2d at 534.

Appendix B

In reviewing a motion to dismiss under Rule 12(b)(6), the court must assume the truth of all factual allegations and must construe them in the light most favorable to the nonmoving party. *Cahill v. Liberty Mut. Ins. Co.*, 80 F.3d 336, 337-38 (9th Cir. 1996). However, legal conclusions need not be taken as true merely because they are cast in the form of factual allegations. *Roberts v. Corrothers*, 812 F.2d 1173, 1177 (9th Cir. 1987); *Western Mining Council v. Walt*, 643 F.2d 618, 624 (9th Cir. 1981). When ruling on a motion to dismiss, the court may consider the facts alleged in the complaint, documents attached to the complaint, documents relied upon but not attached to the complaint when authenticity is not contested, and matters of which the Court takes judicial notice. *Parrino v. FHP, Inc.*, 146 F.3d 699, 705-06 (9th Cir. 1998); *Branch v. Tunnell*, 14 F.3d 449, 453-54 (9th Cir. 1994); *MGIC Indem. Co. v. Weisman.*, 803 F.2d 500, 504 (9th Cir. 1986).

Section 10(b) of the Securities and Exchange Act of 1934 makes it unlawful to use in connection with "the mails or facilities of interstate commerce" any "manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commissioner may prescribe." 15 U.S.C. § 78j. SEC Rule 10b-5, promulgated under section 10(b), provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

Appendix B

(a) To employ any device, scheme or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

In order for Plaintiffs to properly allege their first claim of relief brought under section 10(b) of the Exchange Act and SEC Rule 10b-5, they must state the following: (1) defendants made a false statement or omission with regard to a material fact; (2) in connection with the purchase or the sale of a security; (3) with scienter; (4) upon which plaintiff reasonably relied; (5) to his/her harm or detriment. *Binder v. Gillespie*, 184 F.3d 1059, 1063 (9th Cir. 1999), *cert. denied*, 528 U.S. 1154 (2000); *Paracor Fin., Inc. v. General Elec. Capital Corp.*, 96 F.3d 1151, 1157 (9th Cir. 1996). Scienter is a "mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n. 12 (1976); *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 975 (9th Cir. 1999).

Appendix B

In December of 1995, Congress enacted the Private Securities Litigation Reform Act of 1995 ("PSLRA") to establish uniform and stringent pleading requirements for securities fraud actions. The PSLRA specifies the required pleading standard for securities fraud actions:

(1) Misleading statements and omissions

In any private action arising under this chapter in which the plaintiff alleges that the defendant —

(A) made an untrue statement of a material fact; or

(B) omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances in which the were made, not misleading; the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.

15 U.S.C. §78u-4(b)(1).

In addition, the PSLRA requires complaints alleging federal securities fraud to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2). As recently interpreted by the Ninth Circuit, this language requires a private securities plaintiff to plead, particular facts that constitute strong circumstantial evidence of deliberately reckless or conscious misconduct. In *re Silicon Graphics*, 183 F.3d at 977. Recklessness satisfies the scienter requirement only insofar as it reflects some degree of conscious or deliberate misconduct; *i.e.*, "a degree of recklessness that strongly suggests actual intent." *Id.* at 979.

The PSLRA further provides that "the court shall, on the motion of any defendant, dismiss the complaint if the requirements of paragraphs (1) and (2) are not met." 15 U.S.C. § 78u-4(b)(3)(A).

Under Ninth Circuit caselaw, Rule 9(b) imposes two distinct requirements on complaints alleging securities fraud. First, the basic notice requirements of Rule 9(b) require the complaint to "state precisely the time, place, and nature of the misleading statements, misrepresentations, or specific acts of fraud." *Kaplan v. Rose*, 49 F.3d 1363, 1370 (9th Cir. 1994). The Rule imposes a second requirement that the complaint "set forth an explanation as to why the statement or omission complained of was false and misleading." *Yourish v. California Amplifier*, 191 F.3d 983, 993 (9th Cir. 1999) (*quoting In re GlenFed Sec. Litig.*, 42 F.2d 1541, 1548 (9th Cir. 1994) (en banc)). A complaint may satisfy this second requirement in many ways. It may demonstrate that the false or misleading character of a statement was clear

from facts that existed all along and were later revealed. *Yourish*, 191 F.3d at 994; *In re GlenFed*, 191 F.3d at 1549; *DeMarco v. DepoTech Corp.*, 149 F. Supp. 2d 1212, 1223 (S.D. Cal. 2001). It may also "poin[t] to inconsistent contemporaneous statements or information . . . which were made by or available to the defendants." *Yourish*, 191 F.3d at 994 (*quoting In re GlenFed*, 42 F.3d at 1549); *DeMarco*, 149 F. Supp. 2d at 1223. A complaint may not, however, demonstrate that a statement was false or misleading when made "merely by pointing to later inconsistent statements or conditions." *In re GlenFed*, 42 F.3d at 1548; *DeMarco*, 149 F. Supp. 2d at 1223.

II. Sufficiency of the SAC's Allegations.

Plaintiffs contend that Defendants misrepresented the Company's sales and business performance throughout the Class Period and thereby inflated Dura's stock price. Specifically, Plaintiffs contend Defendants misrepresented: (1) the effectiveness of its sales force; (2) the development of its Spiros Albuterol product; (3) the sales and success of Rondec; (4) and the sales of its major drugs, including Ceclor and Nasalide. The Court will address the sufficiency of these allegations in turn.

A. Statements Regarding Dura's Sales Force.

Plaintiffs contend that Defendants made numerous representations regarding the quality of its sale force. Specifically, on April 15, 1997, in its 1996 Annual Report, Dura stated that it was

able to access about 52% of total respiratory prescriptions written with its highly focused, yet relatively small, sales and marketing organization. The Company's goal is to increase its sales organization to approximately 280 by year-end 1997.

* * *

Dura's highly motivated sales people have proven sales records. . . . Their concentration on respiratory disease, coupled with extensive product and sales training, differentiates them from their competition.

* * *

> Dura's highly trained sales representatives have established credibility. . . . Due to the concentrated nature of the Company's target market, Dura can achieve significant penetration with a relatively small sales force.

(SAC ¶ 51.) Plaintiffs allege that less than one month later, on May 7 and 9, 1997, analysts UBS Securities ("UBS") and William Blair & Co. ("William Blair"), respectively, issued reports on Dura after discussions with Garner and Newman and repeated information provided by them. (SAC ¶ 75.) In these reports, the analysts stated that Dura expected to have 350 reps in place by the time Albuterol Spiros is introduced in late 1998. (SAC ¶ 75.) Similarly, Plaintiffs contend that on June 30, 1997, William Blair reported that

Newman told analysts, money portfolio managers, institutional investors, brokers and stock traders in a formal presentation that:

> One of the main reasons Dura could capture additional licensing/co-promotion agreements was that it had a highly specialized sales force of about 250 reps that were focused on the respiratory prescription market. Although Dura's sales force was relatively small, it still could call on almost 45-50% of the high respiratory prescription writers.

(SAC ¶ 82.)

Plaintiffs also state Dura misrepresented the quality and effectiveness of its sales force in a July 15, 1997 press release, when Dura reported better-than-expected Q2 1997 results. (SAC ¶ 85.) In the press release, Garner stated that part of the quarter's success was due in part to Dura "benefitting from [its] more experienced and expanded sales force, which currently totals approximately 225 representatives. . . ." (SAC ¶ 85.) Similarly, when reporting better-than-expected Q3 1997 results, Dura issued a press release where Garner stated that the increase in Dura's revenues was due in part to "the expansion of the sales force." (SAC ¶ 111.) Vector Securities International ("Vector") reported that in a follow-up conference call on October 14, 1997, Defendants stated that the Company projected it would have 300 sales reps by the end of the year and 350 reps at the point that Albuterol Spiros would be launched. (SAC ¶ 112.) Finally, Plaintiffs allege that when Dura issued a press-release regarding its better-than-expected Q4 1997 results, it represented that revenues had increased

in part because of "the increased productivity of the Company's expanded sales force." (SAC ¶ 128.)

Plaintiffs allege these statements were false when made because in reality, Dura's sales force was inefficient, underpaid, and suffered from an extremely high rate of turnover. (SAC ¶¶ 52, 77.) In part, this was due to the fact that compensation packages for Dura sales representatives were not competitive with the rest of the pharmaceutical industry. (SAC ¶¶ 52, 77.) Plaintiffs contend that "Dura frequently ignored its stated requirement that sales applicants have a minimum of two years of prior sales experience, thereby reducing the collective quality of the sales force." (SAC ¶¶ 52, 77.) Additionally, Plaintiffs maintain the sales force was hampered by a non-operational software and sales force hand-held computer system during the Class Period. (SAC ¶¶ 53, 58(c), 77.) In particular, malfunctions with the "Precise System" that the contractor installed seven months late in April 1997 hampered Dura's sales force's performance. (SAC ¶¶ 53, 77.) By December 1997, these malfunctions allegedly worsened to the point they prevented Dura from preparing necessary quarterly inventory reports or accurate FDA reporting. (SAC ¶¶ 53, 77.) Plaintiffs allege that in fact, Dura was encountering "serious and persistent problems with its sales force which was inadequately trained, was suffering from very high turnover and was insufficient in number and skill to adequately market Dura's drug products, including Ceclor CD, Keftab and Rondec." (SAC ¶ 58(b), 8b(b), 114(b), 129.)

Plaintiffs' allegations regarding the falsity of the Company's statements are conclusory and insufficient. There are no factual allegations to support the assertion the sales

force was suffering from serious and persistent problems, and were inefficient and underpaid, or that Defendants knew this at the time. Rather, the SAC states that sometime after the Class Period Dura admitted that its sales force was inadequate and suffered from a high rate of turnover, which contributed to Dura's poor sales. (SAC ¶¶ 34, 135.) These post-Class Period statements fail to establish that the Defendants' statements during the Class Period were false and made with knowledge of their falsity. *See In re GlenFed*, 42 F.2d at 1548 (stating that a complaint cannot demonstrate that a statement was false or misleading when made "merely by pointing to later inconsistent statements or conditions"); *DeMarco*, 149 F. Supp. 2d at 1223 (same). The SAC also does not contain the requisite detail to support its position that the sales force did not have the requisite two years' experience. The most specificity alleged is regarding Dura's dissatisfaction with the "Precise System" from Walsh International. (*See* SAC ¶¶ 53-54 and Exh. A thereto.) But the malfunctions with the Precise System do not necessarily support the conclusion that the sales force lacked the requisite skill to market Dura's products.

The SAC also is conclusory in alleging scienter regarding these problems with the sales force. Plaintiffs contend Defendant Woodbury sent a letter to Walsh complaining about the Precise System and therefore Defendants knew about the problems plaguing Dura's inventory systems. (SAC ¶¶ 54, 78 and Exh. A thereto.) That letter, however, does not contain any admissions that Dura's sales force was substandard. (SAC Exh. A.) Rather, the letter details the deficiencies of the Precise System and rescinds the agreement between Walsh and Dura. *Id.*

Plaintiffs also allege that Defendants knew about the sub-standard quality of the sales force because Defendants were "hands-on" managers and attended weekly executive management meetings from 8:00 to 10:00 a.m. every Monday. (SAC ¶¶ 59, 87, 115, 129, 148-49.) A complaint does not adequately plead scienter by claiming that key officers knew the true facts by virtue of their "hands-on" positions, involvement in the day-to-day management of the company, and access to various internal documents and reports. *See In re Splash Sec. Litig.*, 160 F. Supp. 2d 1059, 1079-81 (N.D. Cal. 2001) (holding that allegations of scienter based on unspecified corporate documents, unspecified conversations with corporate officers and employees, attendance at unspecified meetings, and unspecified communications with customers were insufficient); *In re Autodesk, Inc. Sec. Litig.*, 132 F. Supp. 2d 833, 843-44 (N.D. Cal. 2000) (holding that "plaintiffs must do more than allege that these key officers had the requisite knowledge by virtue of their 'hands on' positions, because that would eliminate the necessity for specially pleading scienter, as any corporate officer could be said to possess the requisite knowledge by virtue of his or her position"); *In re Read-Rite Corp. Sec. Litig.*, 115 F. Supp. 2d 1181, 1185 (N.D. Cal. 2000) (stating that "[o]ne *reasonably* could infer that persons with [defendants'] job titles would be aware of major developments concerning a key customer's refusal to implement a major product line. However, under current law, the mere existence of a reasonable inference does not satisfy the Reform Act's requirement of a strong implication."). Accordingly, these allegations are do not sufficiently plead scienter.

Further, insofar as Plaintiffs rely on indirect evidence of scienter based on insider stock sales, those allegations are

deficient. Unusual or suspicious stock sales can serve as circumstantial inference of scienter. *In re Silicon Graphics*, 183 F.3d at 986; *In re Splash*, 160 F. Supp. 2d at 1081; *In re Petsmart, Inc. Sec. Litig.*, 61 F. Supp. 2d 982, 999-1000 (D. Az. 1999). "But, courts have repeatedly held that the mere existence of stock sales does not raise a strong inference of fraudulent intent. [citation] Plaintiffs have the burden at the pleading stage of explaining why the stock sales were unusual or suspicious." *In re Petsmart*, 61 F. Supp. 2d at 1000; *See In re Silicon Graphics*, 183 F.3d at 986. To meet this burden, the plaintiffs must show the trading was "'in amounts dramatically out of line with prior trading practices, at times calculated to maximize personal benefit from undisclosed inside information.'" *In re Petsmart*, 61 F. Supp. 2d at 1000 (*quoting Alfus v. Pyramid Tech. Corp.*, 764 F. Supp. 598, 605 & n.1 (N.D. Cal. 1991)); *In re Silicon Graphics*, 183 F.3d at 986; *In re Splash*, 160 F. Supp. 2d at 1081. Here, the SAC does not contain any allegations indicating that the Individual Defendants' trading practices were dramatically out of line with their prior practices. (*See* SAC ¶¶ 24, 37, 154-70.) Further, Defendants have presented the Individual Defendants' Forms 4 and 5 filed with the Securities and Exchange Commission beginning in February 1992 to February 1998 which suggest the Defendants' stock sales during the Class Period were consistent with the pre-Class Period sales. (*See* Defs' Req. for Jud. Ntc. Exhs. E-K.) Accordingly, the allegations do not meet the requirements for pleading scienter based on stock sales as required under *Silicon Graphics*.[1]

1. The SAC also relies on Black-Scholes options valuation as evidence that the timing of the Individual Defendants' stock sales

(Cont'd)

B. Statements Regarding Spiros Drug Delivery System.

Plaintiffs allege that Dura made numerous misrepresentations regarding Dura's Albuterol Spiros drug delivery technology. In particular, Plaintiffs contend that Defendants

(Cont'd)

was suspicious. The Black-Scholes model is used to calculate the value of stock options. (SAC ¶ 158.) Plaintiffs state this formula demonstrates that "a rational investor in an environment of efficient markets, relying solely upon public information, would not exercise an option to purchase a non-dividend paying stock prior to the expiration date of the option . . . [because] early exercise of an option to purchase forfeits the time value of the option between the date of exercise and the date the option expires." *Id.* Plaintiffs contend that the Ninth Circuit has relied on this model, holding that non-marketable options are to be evaluated using established financial methods such as the Black-Scholes formula. (Oppo. at 33-35 (*citing Custom Chrome v. Commissioner of Internal Revenue*, 217 F.3d 1117, 1124 n. 10 (9th Cir. 2000)).

But *Custom Chrome* is inapposite. That case involved a taxpayer's appeal of the tax court's determination that the warrants issued by it to its lender in connection with a loan transaction had no value, so the taxpayer was not entitled to a deduction. The facts of *Custom Chrome* are therefore distinguishable and the case does not suggest that the Black-Scholes model can or should be used to establish scienter in a securities fraud case. Plaintiffs have not cited, nor has the Court found, any cases applying the Black-Scholes model to cases such as this one. Further, the probativeness of the Black-Scholes model to establish scienter is questionable because it does not consider — as *Silicon Graphics* states is appropriate to consider — the individual circumstances of the insider. Accordingly, the SAC's allegations regarding the Black-Scholes model do not support an inference of scienter.

touted the capabilities of its Spiros drug delivery technology in Dura's 1996 annual report, and when announcing better than expected Q1 1997 results, stated that it was continuing to develop its Spiros Albuterol product. (SAC ¶¶ 55, 56.) Plaintiffs allege that as a result of these statements, Dura's stock soared from $\$27^{7}/_{8}$ on April 14, 1997, to $34 on April 15, 1997. (SAC ¶ 57.)

On April 15, 1997, Oppenheimer & Company, Inc. ("Oppenheimer"), Alex. Brown, Robertson Stephens & Co. ("Robertson Stephens"), and William Blair issued reports on Dura and the development of Spiros that were based on and repeated information provided in an April 15, 1997 conference call with securities analysts in conjunction with the 1996 Annual Report and press release and in follow-up conversations with Garner or Newman. (SAC ¶ 71.) These reports stated that Spiros' development was on track and would soon be completing clinical trials. (SAC ¶ 71.) Shortly thereafter on April 24, 1997, Oppenheimer issued a report on Dura based on and repeated information concerning Dura's Spiros development provided in conversations with Garner and Newman that stated that Albuterol Spiros would be submitted to the FDA before the end of the year. (SAC ¶ 72.) On April 28, 1997, UBS issued a report on Dura that was based on and repeated information concerning Dura's Spiros development provided in conversations with Dura executives, including Garner or Newman, that stated that Spiros was allowing Dura to differentiate itself from a typical marketing company and the Company would become more "fully integrated" through the development of the Spiros inhaler. (SAC ¶ 73.) The report also stated that the company would file the NDA in the second half 1997 and expected it to be

approved in the second half of 1998, with Spiros revenues adding about $58 million to Dura's current sales base in 1999. *Id.* On May 8 and May 30, 1997, Vector issued similar reports stating that Dura was still on track to submit its first Spiros NDA filing in the second half of 1997. (SAC ¶¶ 75, 76.) On May 30, 1997, Alex. Brown also reported that Dura would file its NDA for Albuterol Spiros in the second half of 1997 that could add $100 million in revenues by 2000. (SAC ¶ 76.)

Plaintiffs maintain Dura's June 5, 1997 press release announcing the completion of clinical trials necessary for a NDA submission for Albuterol Spiros was false and misleading. (SAC ¶ 79.) In that release, David S. Kabakoff, Dura's Executive Vice President and President and CEO of Spiros Corp. stated Dura was pleased with the results to date and was preparing the NDA for fling in the latter half of 1997. *Id.* On June 30, 1997, William Blair reported that Newman had stated at an investment conference that Dura planned to file the Albuterol Spiros NDA by fall of 1997 and that the Company was continuing to develop the Spiros product line aggressively. (SAC ¶ 82.) On July 15, 1997, Dura reported better-than-expected Q2 1997 results in a press release, and reiterated that the Company was on track to file the Albuterol Spiros NDA in the second half of 1997. (SAC ¶ 85.) Also on that date, five analysts issued reports on Dura that were based on and repeated information provided in a conference call and in follow-up conversations with Garner and Newman. (SAC ¶ 94.) The analysts reported Dura was on track to file the Albuterol Spiros NDA in the second half of 1997, that Albuterol Spiros could be on the market in late 1998 with initial sales of $10 million growing

to over $55 million by 2000, and that Albuterol Spiros would contribute significantly to Dura's long-term revenue and earnings growth. *Id.*

In August 1997, analysts issued reports on Dura that were based on and repeated information from Garner and Newman stating that Spiros possessed significant advantages over alternative inhalers currently marketed or in development, and the launch of Albuterol Spiros in the second half of 1998 would be a watershed event for the Company. (SAC ¶¶ 103-04.) Analysts issued similar positive reports on September 1997 based on discussions with Garner and Newman. (SAC ¶ 105.) On October 8, 1997, Dura reported at the UBS Life Science Conference that the NDA filing for Albuterol Spiros was expected within days. (SAC ¶¶ 106, 108.)

In mid-October, Dura reported better-than-expected Q3 1997 results. (SAC ¶ 111.) Plaintiffs contend that in a conference call and follow-up conversations with analysts, Defendants reiterated that the NDA for Albuterol Spiros would be filed in November 1997, and continued to tout the significance of Albuterol Spiros on the Company's future revenues. (SAC ¶¶ 122, 123.) After Dura reported better-than-expected Q4 1997 results, analysts issued reports based on conversations with Garner or Newman that stated Dura expected the FDA to approve Albuterol Spiros by the end of 1998. (SAC ¶¶ 128, 130-31.) The analysts further reported Dura expected to launch Albuterol Spiros by early 1999, and that the product would be a significant portion of the company's revenue. (SAC ¶¶ 130-31.)

Plaintiffs contend that the statements regarding Albuterol Spiros' development were false and misleading when made because Defendants knew that Dura's NDA for Albuterol Spiros would be rejected by the FDA, Dura would be required to completely redo its Phase III clinical human trials, and that the product would be delayed in reaching the market, if it did reach the market. (SAC ¶¶ 66, 68, 80, 83, 96, 98, 109, 125, 133.) Plaintiffs maintain that Albuterol Spiros was unreliable and plagued by significant electro-mechanical problems that caused over 30% of the inhalers to fail during clinical trials. (SAC ¶¶ 66, 68, 80, 83, 96, 98, 109, 125, 133.) Plaintiffs allege Dura modified the device while the trials were ongoing to address the reliability problems. (SAC ¶¶ 69, 81, 83, 99, 109, 125, 133.)

According to Plaintiffs, Defendants allegedly knew about serious problems with the stability of Albuterol Spiros in 1996 even before Phase III clinical trials began. (SAC ¶¶ 67, 80, 83, 97, 109, 125, 133.) Specifically, Dura found that Albuterol was unstable when aged and subject to clumping which reduced its efficacy when exposed to humidity. (SAC ¶¶ 67, 80, 83, 97, 109, 125, 133.) Plaintiffs state that Defendants also knew about reliability problems plaguing the Spiros device and Albuterol stability problems from a list Bob Eisele, Vice President of Product Development, prepared in October 1996. (SAC ¶¶ 70, 80, 83, 100, 109, 125, 133.) The Eisele list set forth items that needed to be addressed before an NDA could be submitted, and Dura's engineers recommended further development before NDA submission. (SAC ¶¶ 70, 80, 83, 100, 109, 125, 133.) In addition, Plaintiffs allege that Dura representatives, including Defendants Garner and Prettyman, attended a

pre-filing meeting with the FDA in May 1997 where the FDA informed Dura it was concerned with the Spiros device's reliability and with Albuterol's stability. (SAC ¶¶ 80, 83, 101, 109, 125, 133.) Plaintiffs further contend that in October 1997, there was internal dissension in Dura between Defendants about whether to file the NDA for the Spiros device. (SAC ¶¶ 125, 133.)

One of the elements of a Rule 10b-5 cause of action that a Plaintiff must plead and prove is loss causation. 17 C.F.R. § 240.10b-5; Binder, 184 F.3d at 1063. "The causation requirement in Rule 10b-5 securities fraud cases includes 'both transaction causation, that the violations in question caused the plaintiff to engage in the transaction, and loss causation, that the misrepresentations or omissions caused the harm.'" Binder, 184 F.3d at 1065 (*quoting McGonigle v. Combs*, 968 F.2d 810, 820 (9th Cir. 1992)). In the Ninth Circuit, loss causation is satisfied where "the plaintiff shows that 'the misrepresentation touches upon the reasons for the investment's decline in value.'" *Id.* at 1066 *(quoting McGonigle*, 968 F.2d 821); *accord Provenz v. Miller*, 102 F.3d 1478, 1492 (9th Cir. 1996). At the pleadings stage, plaintiffs do not need to meet a strict test of direct causation; they need only show "some causal nexus" between the defendants' misconduct and the plaintiffs' losses. *In re Controlled Data Corp. Sec. Litig.*, 933 F.2d 616, 619 (8th Cir. 1991).

Defendants argue that Plaintiffs fail to show loss causation because there are no allegations that Defendants' purported misrepresentations and omissions about Albuterol Spiros caused or had any relation to the decline in value of

Plaintiffs' investment. Plaintiffs contend they have properly pled loss causation because they have alleged that the stock price on the date of purchase was inflated because of the misrepresentations or omissions and they would not have purchased the stock had they known about Defendants' wrongdoing. These allegations are not sufficient to withstand a motion to dismiss.

The last day of the Class Period in this action is February 24, 1998. On that date, Dura announced an expected future revenue shortfall in 1998 due to "slower Ceclor CD and Nasarel/Nasalide sales and the immediate need to vastly increase the size of Dura's sales force from 270 to over 450 to try to boost sales of existing products." (SAC ¶¶ 32, 134.) As a result, even though the Dow Jones average went up 87.7 points on February 25, 1998, Dura's stock price fell 47%, trading at $39^{1}/_{8}$ on February 24, 1998 to $20^{3}/_{4}$ on February 25, 1998. (SAC ¶¶ 32, 134.) The SAC does not allege that the February 24, 1998, announcement contained any negative information about Albuterol Spiros. Rather, Dura did not announce that the FDA would not approve Albuterol Spiros until nine months later, in November 1998. (SAC ¶ 136.) The SAC does not contain any allegations that the FDA's non-approval had any relationship to the February price drop. Accordingly, the SAC does not explain how the alleged misrepresentations and omissions regarding Albuterol Spiros "touched" upon the reasons for the decline in Dura's stock price. Rather, the decline in Dura's stock price was the result of an expected revenue shortfall. Accordingly, the SAC's allegations regarding Albuterol Spiros are insufficient to state a claim.

C. Statements Regarding Dura's Sales and Business Performance.

Plaintiffs contend that Defendants misrepresented and omitted critical information regarding Dura's sales of its products, specifically Ceclor CD and Nasalide. In addition, Plaintiffs contend that Defendants inflated its revenues by failing to take a write-down on its Rondec product line. Specifically, Plaintiffs allege that on April 15, 1997, Dura announced in a press release better-than-expected Q1 1997 results, stating that revenues for the quarter totaled $40.9 million, net income was $8.8 million, and EPS were $0.19 — a 74% increase from $0.11 in first quarter 1996. (SAC ¶ 56.) Defendants reported that "Dura doubled the Ceclor® CD share of cefaclor weekly from new prescriptions over fourth quarter 1996 to 15%, up from 7.5% at year end. Commenting on this increase, Garner noted 'Since the product launch just 20 weeks ago, our sales representatives have been successfully delivering the message to high prescribing physicians of patient compliance advantages of Ceclor® CD over Ceclor® in the treatment of bronchitis." *Id.* The press release also quoted Garner as stating "[w]e are very pleased with first quarter results . . . we are happy with the strong progress made in selling our new respiratory antibiotic, Ceclor® CD." *Id.* On June 30, 1997, William Blair reported that Defendant Newman announced at the William Blair 1997 Investment Conference that Ceclor CD continued to gain market share, with an approximate 17.9% share of the cefaclor market, versus 16.9% at the end of April and 7.5% at the end of December 1996. (SAC ¶ 82.)

Appendix B

On May 7, 1997, Dura announced it had acquired the Nasarel/Nasalide spray product line from Roche Holding AG. (SAC ¶ 74.) Defendant Garner stated that the Nasarel and Nasalide products fit within Dura's respiratory focus, adding a new respiratory category to the Company's product portfolio. *Id.*

On July 15, 1997, Dura reported better-than-expected Q2 1997 results in a press release, stating that net income for the second quarter totaled $9.3 million, or $0.20 per share on revenues of $43.6 million compared to net income of $4.6 million, or $0.12 per share, on revenues of $18.8 million in the second quarter that ended June 30, 1996. (SAC ¶ 85.) Garner stated the company was pleased with Dura's performance in the second quarter of 1997, and that Ceclor CD and Keftab were well received by physicians who were responding favorably to Dura's promotional efforts. *Id.*

On October 8, 1997, Dura representatives appeared at the UBS Life Science Conference. (SAC ¶ 106.) UBS thereafter reported that Dura presented compelling market share data regarding Ceclor CD's progress in the U.S. cefaclor cephalosporin franchise, and that Ceclor registered nearly a three-point sequential increase in market share between August and September. *Id.* Shortly after the conference, Dura announced better-than-expected 3Q 1997 results, reporting record earnings for both the third quarter and nine months year-to-date of 1997, compared to the same period the previous year. (SAC ¶ 111.) The Company stated that net income for the third quarter totaled $11.3 million, or $0.24 per share, on revenues of $43.3 million compared to net income of $5.8 million, or $0.14 per share, on revenues of $25.9 million for the third quarter ended September 30, 1996.

Appendix B

Id. Dura primarily attributed the increase in revenues to growth in sales of respiratory pharmaceuticals, which rose 91% to $36.1 million in the third quarter of 1997 compared to $18.9 million in the third quarter of 1996. *Id.* The pharmaceutical sales growth was largely due in part to the impact of new product acquisitions and introductions, such as Ceclor CD and Nasarel. *Id.* In a follow-up conference call, Vector reported Dura's management indicated that earnings for 1998 could run in the low $1.40's range. (SAC ¶ 112.)

On January 20, 1998, Dura reported better-than-expected Q4 1997 results, stating revenues were at $53.5 million and $181.3 million for the quarter and the full year, respectively. (SAC ¶ 128.) Excluding one-time charges, Dura would have had a net income of $18.0 million, or $0.37 per share in the quarter, and $47.4 million, or $0.99 per share for the year, compared to a net income of $9.9 million, or $0.22 per share for the fourth quarter of 1996 and $24.3 million, or $0.60 per share for the full year 1996. *Id.* Dura also reported that its sales from pharmaceuticals rose 89% to $150 million in 1997 compared to $79.6 million in 1996, due in part to product acquisitions. *Id.* In a press release, Garner was quoted as stating that the Company's Ceclor CD market share of the oral solid cefaclor market rose from 8% at the beginning of 1997 to 25% by year-end. *Id.*

1. Plaintiffs' Falsity and Scienter Allegations Regarding Defendants' Statements About Sales of its Products.

Plaintiffs contend the Defendants misrepresented Dura's revenues from the sales of its products, particularly Ceclor CD and Nasalide. Plaintiffs allege these statements were false

and misleading because "sales of Dura's major drug products were flat or declining, especially Ceclor CD, whose sales levels were dropping throughout the Class Period." (SAC ¶¶ 58(a), 114(a), 129.) Plaintiffs argue that to cover up the sales shortfalls, Dura artificially inflated its revenues and EPS by shipping excessive amounts of Ceclor CD and other products to wholesalers, who were enticed to take the product by price discounts, extended payments terms and/or other incentives. (SAC ¶¶ 58(d), 86(c), 114(c), 129.) Plaintiffs state that Dura recognized revenue on the sale of a product when it shipped the product to drug wholesalers, who in turn resold the drug to pharmacies, drug chains, or even individual physicians. (SAC ¶¶ 65, 93, 121, 129.) Because Dura did not publicly disclose to analysts or investors sales of each of its various drug products, analysts and investors did not know that Dura was shipping amounts of Ceclor CD to wholesalers well in excess of the amount justified by or necessary to keep pace with current prescription levels. (SAC ¶¶ 65, 93, 121, 129.) As a result, Dura's Ceclor CD and other product inventories in the distribution channel were greatly in excess of the normal one-month supply. (SAC ¶¶ 58(d), 65, 93, 114(c), 121, 129.) Plaintiffs state that these excessive inventory levels would eventually have to be worked off, causing sales and earnings to drop. (SAC ¶¶ 65, 93, 114(c), 121, 129.)

Plaintiffs' allegations regarding Nasalide are conclusory and insufficient. Plaintiffs allege that Nasalide sales were "poor and well below expectations," (SAC ¶ 86(d), ¶ 114(d), 129), but they do not specify facts or evidence to support this contention. As the Ninth Circuit noted in *Ronconi v. Larkin*, 253 F.3d 423, 431 (9th Cir. 2001), "[i]t is not sufficient

simply to allege that a statement was false. Plaintiffs must state with particularity all facts upon which their beliefs]" are based.

Plaintiffs' allegations regarding Ceclor CD sales have more specificity in that Plaintiffs contend that monthly sales reports showed that Ceclor CD sales began dropping around March-April 1997, and significantly worsened during summer of 1997. (SAC ¶¶ 63, 119, 129.) As a result, according to Plaintiffs, the reports showed that sales were 25-40% below internal projections at that time. (SAC ¶¶ 63, 119, 129.) Monthly sales reports showed that Ceclor CD sales dropped from 47,288 in March 1997 to 39,808 in May 1997 to 24,797 in July 1997. (SAC ¶¶ 63, 119, 129.) But as this Court found in its earlier order, "[t]he mere fact that intraquarterly results lagged behind internal projections does not, without more, require disclosure." *Glassman v. Computervision Corp.*, 90 F.3d 617, 631 (1st Cir. 1996). Further, the SAC allegations regarding Ceclor are conclusory in that while Plaintiffs allege the Company was shipping amounts of the product "well in excess of the amount justified by or necessary to keep pace with current prescription levels and thus Dura had created vastly excessive amounts of inventory of Ceclor CD in the distribution channel," (SAC ¶¶ 65, 93), the SAC does not provide any factual support on how Defendants knew at the time the distribution channels were clogged. Rather, Plaintiffs state that after the Class Period ended, Dura admitted there was excessive inventory of Ceclor CD. (SAC ¶¶ 34, 135.) As with the SAC's allegations regarding Dura's sales force, post-Class Period statements are not sufficient to indicate that the Defendants' statements regarding Ceclor sales during the Class Period

were false and made with knowledge of their falsity. *See In re GlenFed*, 42 F.2d at 1548 (stating that a complaint cannot demonstrate that a statement was false or misleading when made "merely by pointing to later inconsistent statements or conditions"); *DeMarco*, 149 F. Supp. 2d at 1223.

In addition, Plaintiffs' allegations that Defendants knew their statements regarding Dura's revenues from sales were false when made are deficient. First, the SAC's allegations of scienter based on insider stock sales fail for the reasons discussed above in section II.A. Plaintiffs also allege scienter based on Defendants being "hands on" managers who attended weekly management meetings from 8:00 a.m. to 10:00 a.m., and constantly monitored and were informed about the sales of Dura's core products via various internal reports, meetings, and conversations with corporate officers and employees. (SAC ¶¶ 59-62, 64, 87-90, 115-18, 120, 129.) These allegations are not sufficient because they do not identify specific reports, specific information contained in those reports, specific conversations, or specific meetings. *See In re Splash*, 160 F. Supp. 2d at 1079-81 (holding that allegations of scienter based on unspecified corporate documents, unspecified conversations with corporate officers and employees, attendance at unspecified meetings, and unspecified communications with customers were insufficient); *In re Autodesk*, 132 F. Supp. 2d at 843-44 (holding that "plaintiffs must do more than allege that these key officers had the requisite knowledge by virtue of their 'hands on' positions, because that would eliminate the necessity for specially pleading scienter, as any corporate officer could be said to possess the requisite knowledge by virtue of his or her position"); *In re Read-Rite*, 115 F. Supp.

2d at 1185 (stating that "[o]ne *reasonably* could infer that persons with [defendants'] job titles would be aware of major developments concerning a key customer's refusal to implement a major product line. However, under current law, the mere existence of a reasonable inference does not satisfy the Reform Act's requirement of a strong implication).

Further, as this Court found in dismissing the earlier complaint, channel stuffing allegations are insufficient for scienter. Channel stuffing "is the oversupply of distributors in one quarter to artificially inflate sales, which will then drop in the next quarter as distributors no longer make orders while depleting their excess supply." *Steckman v. Hart Brewing, Inc.*, 143 F.3d 1293, 1298 (9th Cir. 1998). The First Circuit has held that [t]here is nothing inherently improper in pressing for sales to be made earlier than in the normal course." *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 202 (1st Cir. 1999). Although Plaintiffs' "channel stuffing" claims may have some probative value insofar as the channel stuffing was done so as to artificially inflate income, "that value is weak." *Id.* at 202-03. Because there may be a number of legitimate reasons for attempting to achieve sales earlier, "channel stuffing" claims "do not support a strong inference of scienter." *Id.* at 203. Indeed, this Circuit has rejected "channel stuffing" claims. *Steckman*, 143 F.3d at 1298. In *Steckman*, the Ninth Circuit stated that *"[t]his claim is speculation made in hindsight." Id.* (emphasis added).

Accordingly, Plaintiffs' allegations that Dura misrepresented its sales because sales of its products were not as robust as stated are insufficient to withstand a motion to dismiss.

2. Sufficiency of Plaintiffs' Falsity and Scienter Allegations Regarding Defendants' Statements About Rondec.

Plaintiffs contend that Dura misrepresented its revenues because the Rondec and Dura-Vent product lines were suffering very poor sales. (SAC ¶¶ 58(e), 86(e), 114(e). Plaintiffs maintain sales of these products were declining so rapidly and performing so poorly that Dura would not be able to recover its remaining investment in Rondec from those sales. (SAC ¶¶ 58(e), 86(e), 114(e).) Plaintiffs contend that Dura falsified and artificially inflated its Q1 1997 EPS by failing to take required write-downs on the carrying value of its investment in the Rondec product line, which were required because the sales of the product line had so declined and were so poor that Dura could not recover its remaining investment in Rondec. (SAC ¶¶ 58(f), 86(f), 114(f)).

In brief, Plaintiffs' claim regarding Rondec is that Defendants violated GAAP in its valuation. Violations of GAAP standards can provide evidence of scienter. *Greebel*, 194 F.3d at 203; *see In re McKesson HBOC, Inc. Sec. Litig.*, 126 F. Supp. 2d 1248, 1273 (N.D. Cal. 2000) ("However, when significant GAAP violations are described with particularity in the complaint, they may provide powerful indirect evidence of scienter. After all, books do not cook themselves.") "To support even a reasonable inference of scienter, however, the complaint must describe the violations with sufficient particularity; 'a general allegation that the practices at issue resulted in a false report of company earnings is not a sufficiently particular claim of misrepresentation.'" *Greebel*, 194 F.3d at 203 (*quoting Gross v.*

Summa Four, Inc., 93 F.3d 987, 996 (1st Cir. 1996)). When contending that a write-down was done too late, "[t]he pleading must provide some particularized support regarding inventory levels, the defendants' knowledge, and approximately when plaintiffs think the write-down should have occurred." *In re Petsmart*, 61 F. Supp 2d at 993. Here, Plaintiffs contend that Dura should have recorded an impairment charge for the Rondec investment or accelerate the amortization of the asset sales of Rondec because sales of that product were low, (SAC ¶ 145), but fail to allege particularized facts regarding Rondec's inventory levels. Nor does the SAC give any factual support for how the timing of the Rondec charge was unusual or reckless or give any specificity as to when the Defendants knew it should have been done.

Moreover, like the announcement of the FDA's non-approval of Albuterol Spiros, the $28 million charge Dura took for Rondec did not occur until after the Class Period ended. (*See* SAC ¶ 145.) While the SAC does not specify the date when the charge was taken, it alleges the charge occurred sometime after the December 1998 reconsolidattion of DJ Pharma back into Dura. *Id.* Notably, however, Plaintiffs have not alleged how the write-down "touched upon" the February 1998 drop in Dura's stock price. The February 24, 1998 announcement that precipitated the the drop in Dura's stock price concerned a revenue shortfall due to slower Ceclor CD and Nasarel/Nasalide sales and the immediate need to increase the size of Dura's sales force. (SAC ¶¶ 32, 134.) There are no allegations indicating the announcement contained any information about Dura's investment in Rondec. Accordingly, Plaintiffs' allegations

regarding Rondec fail for the alternative reason that Plaintiffs have not properly alleged loss causation as to the Rondec misrepresentations and omissions. *See Binder*, 184 F.3d at 1066 (holding that loss causation is satisfied where "the plaintiff shows that the 'misrepresentation touches upon the reasons for the investment's decline in value'" (*quoting McGonigle*, 968 F.2d 821); *accord Provenz*, 102 F.3d at 1492); *In re Controlled Data*, 933 F.2d at 619 (holding that at the pleadings stage, plaintiffs must allege "some causal nexus" between the defendants' misconduct and the plaintiffs' losses).

III. Section 20(a) Claim.

Rule 20(a) of the 1934 Securities and Exchange Act provides for controlling person liability for every person who, directly or indirectly, controls any person liable under any of the provisions of this title. 15 U.S.C. § 78t(a). To establish control person liability, however, a plaintiff must show that a primary violation occurred. *Wenger v. Lumisys, Inc.*, 2 F. Supp. 2d 1231, 1252 (N.D. Cal. 1998). Accordingly, because Plaintiffs' § 10(b) claim is being dismissed, their claim under § 20(a) is dismissed as well.

IV. Defendants' Request for Judicial Notice.

Defendants have requested the Court take judicial notice of various press releases, Dura's l0K and l0Q forms. Plaintiffs have not challenged this request. Accordingly, Defendants' request is **GRANTED** insofar as the Court has relied on those documents for its analysis, it takes judicial notice of them under Federal Rule of Evidence 201.

CONCLUSION

Having reviewed the SAC, the parties' briefs and oral argument, applicable law, and good cause appearing, **IT IS HEREBY ORDERED.**

1. Defendants' motion to dismiss is **GRANTED.**

2. Because the Plaintiffs have had an opportunity to amend the complaint to meet the pleading requirements under the PSLRA and *Silicon Graphics*, the Second Consolidated and Amended Complaint is **DISMISSED WITH PREJUDICE.**

3. Defendants' request for judicial notice is **GRANTED** insofar as the Court has relied on those documents.

4. The Clerk of the Court is directed to enter judgment in this action, and the judgment shall apply to all matters that have been consolidated to the instant master file, *In re Dura Securities Litigation*, 99cv0151-L(NLS).

IT IS SO ORDERED.

Dated: 11/2/01

s/ M. James Lorenz
M. JAMES LORENZ
UNITED STATES DISTRICT JUDGE

APPENDIX C — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT DENYING PETITION FOR REHEARING AND REHEARING EN BANC DATED SEPTEMBER 25, 2003 AND FILED SEPTEMBER 29, 2003

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 01-57136

MICHAEL BROUDO,

Plaintiff/Appellant,

v.

DURA PHARMACEUTICALS, INC.; CAM L. GARNER; JAMES W. NEWMAN; CHARLES W. PRETTYMAN; WALTER F. SPATH; JAMES C. BLAIR; JULIA R. BROWN; JOSEPH C. COOK, JR.; and MITCHELL R. WOODBURY,

Defendants/Appellees.

ORDER

Before: PREGERSON, REINHARDT, and ARCHER,[1] Circuit Judges.

The panel has voted to deny appellees' petition for rehearing and to ~~reject~~ the suggestion for rehearing en banc.

1. Honorable Glann L. Archer, Jr., Senior United States Circuit Judge for the Federal Circuit, sitting by designation.

Appendix C

The full court was advised of the suggestion for rehearing en banc. No judge of the court has requested a vote on the suggestion for rehearing en banc. Fed. R. App. P.35(b).

The petition for rehearing is denied and the suggestion for rehearing en banc is rejected.

APPENDIX D — STATUTE INVOLVED

15 U.S.C. § 78u-4

* * *

(b) Requirements for securities fraud actions

* * *

(4) Loss causation

In any private action arising under this chapter, the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages.

* * *

(e) Limitation on damages

(1) In general

Except as provided in paragraph (2), in any private action arising under this chapter in which the plaintiff seeks to establish damages by reference to the market price of a security, the award of damages to the plaintiff shall not exceed the difference between the

purchase or sale price paid or received, as appropriate, by the plaintiff for the subject security and the mean trading price of that security during the 90-day period beginning on the date on which the information correcting the misstatement or omission that is the basis for the action is disseminated to the market.

(2) Exception

In any private action arising under this chapter in which the plaintiff seeks to establish damages by reference to the market price of a security, if the plaintiff sells or repurchases the subject security prior to the expiration of the 90-day period described in paragraph (1), the plaintiff's damages shall not exceed the difference between the purchase or sale price paid or received, as appropriate, by the plaintiff for the security and the mean trading price of the security during the period beginning immediately after dissemination of information correcting the misstatement or omission and ending on the date on which the plaintiff sells or repurchases the security.

* * * *